rules and regulations

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Title 14—Aeronautics and Space

CHAPTER I—FEDERAL AVIATION ADMINISTRATION, DEPARTMENT OF TRANSPORTATION

[Docket No. 75-EA-79; Amdt. 39-2503]

PART 39—AIRWORTHINESS DIRECTIVES

United Aircraft of Canada, Ltd.

The Federal Aviation Administration is amending § 39.13 of Part 39 of the Federal Aviation Regulations so as to issue an airworthiness directive applicable to PT6T-3 and PT6T-6 type turboshaft engines.

There have been reports of fuel pump leakage in the Twin-Pac turboshaft type engines. The leakage results from restrictions in the injector nozzle orifice which causes seal failures.

Since this deficiency can exist or develop in similar type designed engines, an airworthiness directive is being issued which will require an inspection of the pump and eventual replacement of the injector cap and screen assembly.

In view of the foregoing and because the deficiency is one which affects air safety, notice and public procedure hereon are impractical and good cause exists for making the amendment effective in less than 30 days.

In consideration of the foregoing and pursuant to the authority delegated to me by the Administrator, 14 CFR 11.89 (31 FR 1369) § 39.13 of Part 39 of the Federal Aviation Regulations is amended by issuing a new airworthiness directive as follows:

UNITED AIRCRAFT OF CANADA LIMITED: Applies to all PT6T-3 and PT6T-6 Series Turboshaft Engines.

Compliance required as indicated unless previously accomplished. To preclude leakage of the Sundstrand Aviation 025277 series fuel pump without the part number 5002557 injector cap and screw assembly, accomplish the following:

(a) Within the next 25 hours in service after the effective date of this A.D., unless previously accomplished, inspect the fuel pump in accordance with paragraph 2 Accomplishment Instructions detailed in Pratt & Whitney Aircraft of Canada Limited Special Instruction No. 5-75 dated August 12, 1975, or approved equivalent inspection.

(b) Within the next 250 hours in service after the effective date of this A.D., unless previously accomplished, install part number 5002557, injector cap and screen assembly, in accordance with paragraph 2 Accomplishment Instructions, Pratt & Whitney Aircraft of Canada Limited Engine Service Bulletin No. 5111 dated September 4, 1975 or approved equivalent alteration. The aircraft may be flown in accordance with FAR 21.197 and 21.199 to a base where the inspection or alteration can be accomplished.

Upon submission of substantiating data, through an FAA Maintenance Inspector, the Chief, Engineering and Manufacturing Branch, FAA Eastern Region, may adjust the repetitive inspection times specified in this A.D.

An equivalent alteration or inspection must be approved by the Chief, Engineering and Manufacturing Branch of the Eastern Region of the FAA.

This amendment is effective February 5, 1976.

(Secs. 313(a), 601, 603, Federal Aviation Act of 1958, (49 U.S.C. 1354(a), 1421, 1423); sec. 6(c), Department of Transportation Act, (49 U.S.C. 1655(c)).)

Issued in Jamaica, N.Y., on January 22, 1976.

DUANE W. FREER,
Director, Eastern Region.

[FR Doc.76-2697 Filed 1-29-76;8:45 am]

[Airspace Docket No. 75-WE-28]

PART 71—DESIGNATION OF FEDERAL AIRWAYS, AREA LOW ROUTES, CONTROLLED AIRSPACE, AND REPORTING POINTS

Alteration of Federal Airways

On November 24, 1975, a notice of proposed rulemaking (NPRM) was published in the FEDERAL REGISTER (40 FR 54429) stating that the Federal Aviation Administration (FAA) was considering an amendment to Part 71 of the Federal Aviation Regulations that would cap Federal Airways V-135, V-208 and V-442 at 10,000 feet MSL in the vicinity of Parker, Calif., to accommodate operations in a military operations area.

Interested persons were afforded an opportunity to participate in the proposed rule making through the submission of comments. Two comments were received. One commenter offered no objection to the proposal. The State of California, Department of Transportation stated that although they agreed the proposed action may have little adverse effect on the IFR use of these particular route segments, they objected to the proposal due to their concern that a precedent for future restrictions on the use of navigable airspace in California may be set.

The agency will assess any future similar action as to the effect on the user as these occasions arise.

Since there is agreement that this proposed action may have little adverse effect on the IFR use of these particular route segments, action is taken herein to amend Part 71.

In consideration of the foregoing, Part 71 of the Federal Aviation Regulation is amended, effective 0901 G.m.t., March 25, 1976, as hereinafter set forth.

Section 71.123 (41 FR 307) is amended as follows:

1. In V-135 "between Yuma and Parker." is deleted and "between Yuma and Parker, and the airspace above 10,000 feet MSL between Parker and Needles." is substituted therefor.

2. In V-208 between "Cherokee, Wyo." and "The airspace" add "excluding the airspace above 10,000 feet MSL between Twentynine Palms and Needles."

3. In V-442 add "The airspace above 10,000 feet MSL between Parker and a point 45 miles northwest is excluded."

(Sec. 307(a), Federal Aviation Act of 1958, (49 U.S.C. 1348(a)); sec. 6(c), Department of Transportation Act, (49 U.S.C. 1655(c)))

Issued in Washington, D.C., on January 23, 1976.

WILLIAM E. BROADWATER,
Chief, Airspace and Air Traffic Rules Division.

[FR Doc.76-2696 Filed 1-29-76;8:45 am]

Title 17—Commodity and Securities Exchanges

CHAPTER II—SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-11942]

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

Off-Board Trading by Members of National Securities Exchanges

The Securities and Exchange Commission, pursuant to the authority vested in it by the Securities Exchange Act of 1934 (the "Act"),[1] is amending 17 CFR Part 240 by adding Section 240.19c-1 ("Rule 19c-1"), effective March 31, 1976. Rule 19c-1 reflects the Commission's determination that certain aspects of those rules of national securities exchanges which limit or condition the ability of members to effect transactions otherwise than on such exchanges ("off-board trading rules"), identified in Securities Exchange Act Release No. 11628 (September 2, 1975) (the "September Report"),[2] impose burdens on competition which cannot be justified in terms of the regulatory objectives of the Act.[3]

Rule 19c-1 will not go into effect until March 31, 1976; prior to that time existing exchange off-board trading rules may continue. After March 31, 1976, and until January 2, 1977, exchange rules may not prevent a member of an exchange, acting as agent, from effecting transactions in listed securities on other exchanges or over-the-counter, with a third market maker or nonmember block positioner, except that exchange rules may require members effecting such

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transactions to satisfy limit orders left with a specialist or represented through any other limit order mechanism. After January 2, 1977, such requirements that limit orders be satisfied will cease to be in effect.

Rule 19c-1, however, will not prevent exchanges from having rules restricting exchange members from effecting transactions "in-house" as agent for both buyer and seller or with persons other than a qualified third market maker or nonmember block positioner.

As used in this release, the term "over-the-counter" refers to all transactions executed otherwise than on the floor of an exchange, including transactions executed by a member firm "in-house" or "upstairs."

A more complete description of Rule 19c-1 is provided in Chapter VI herein.

The Commission has determined not to take any action at this time with respect to off-board restrictions on principal transactions. Despite the anticompetitive effects of such rules and the benefits which the Commission believes would be derived from improved market maker competition, the questions of timing of elimination of these restrictions, and of the need for implementation of additional regulatory and technological changes to ensure that such competition develops in a fair and orderly manner, merit additional study. The Commission intends, however, to reconsider this decision no later than March 1, 1977, after it has had the conclusions and counsel of the National Market Advisory Board. Progress by that date toward implementation of additional elements of a national market system will be material to our decision then as to whether it still appears appropriate to establish a firm date for elimination of off-board restrictions on principal transactions.

I. Introduction

Section 11A(c)(4)(A) of the Act,[4] as added by the Securities Acts Amendments of 1975 (the "1975 Amendments"),[5] directs the Commission to review any and all off-board trading rules of national securities exchanges. The legislative history of section 11A(c)(4)(A) requires the Commission to review such rules *de novo* and to evaluate them in light of the purposes of the Act and in consideration of certain competitive standards made explicit by the 1975 Amendments.[6]

Section 11A(c)(4)(A) also provides that, on or before September 2, 1975, the Commission shall (i) report to the Congress the results of this review, including the effects on competition of these rules, and (ii) commence a proceeding, in accordance with section 19(c) of the Act,[7] to amend any such rules imposing a burden on competition which does not appear to the Commission to be necessary or appropriate in furtherance of the purposes of the Act.

Pursuant to the Congressional mandate of section 11A(c)(4)(A), on September 2, 1975, the Commission reported the results of its review to the Congress, concluding that exchange off-board trading rules did impose burdens on competition,[8] and issued its September Report to the public. The September Report contained the text of the Commission's report to the Congress, proposed certain alternative rules to substitute for existing off-board trading rules (designated as proposed Rules 19c-1 [A], [B], and [C]),[9] and announced commencement of the proceeding required by section 11A(c)(4)(A) of the Act to determine:

(i) The extent to which existing off-board trading rules do engender significant anti-competitive effects;

(ii) Whether, although such rules are anti-competitive, there are countervailing considerations which appropriately outweigh the need to abrogate or amend such rules at the present time; and

(iii) Whether such rules could be appropriately modified so as to further the purposes of the Act.[10]

The September Report solicited comments from interested persons on the Commission's proposed rules in terms of the arguments and considerations expressed in the Commission's report to Congress concerning existing off-board trading rules and in terms of the interests of different types of securities customers and of various segments of the securities industry.[11] The Commission also held eight days of oral hearings, beginning October 14, 1975 and concluding on October 23, 1975 (the "October Hearings"), with respect to existing off-board trading rules and the Commission's proposed rules to examine further those arguments, concerns and interests.[12] In addition, in the course of its review of the materials compiled during the course of the proceeding, the Commission has also considered certain prior studies of the question of off-board trading rules, including, *inter alia*, certain prior hearings,[13] studies, policy statements and reports of advisory committees, as well as Congressional hearings and reports.

II. Background

A. Existing Off-Board Trading Rules

Each of the nation's registered securities exchanges presently has rules which limit or condition the ability of members to effect transactions over-the-counter either for their own accounts (transactions as principal) or for the accounts of others (transactions as agent) in securities listed, or admitted to unlisted trading privileges, on such exchanges.[15] While the procedures a member is required to follow in order to effect such transactions vary from exchange to exchange, such rules have certain salient characteristics in common.

Each existing exchange off-board trading rule requires, at a minimum, that agency orders which a member intends to execute over-the-counter be disclosed on the exchange floor and subjected to possible displacement by one or more categories of buying or selling interest on the floor (i.e., limit orders entered on the specialist's book, public bids or offers represented in the "crowd," and bids and offers by members, including specialists, for their own accounts). These rules generally require that the proposed transaction price in the over-the-counter market must be more favorable than any price bid or offered on the exchange floor. Off-board principal transactions are either proscribed by existing rules (unless permission is obtained in each case) or subject to similar procedures.

Rule 394 of the NYSE permits members to effect off-board agency transactions only upon compliance with certain detailed conditions. Among these are requirements that (i) the transaction may be effected only with a "qualified third market maker," as defined in Rule 19b-1 under the Act;[16] (ii) a "diligent effort" must be made to explore the market on the floor prior to soliciting third market interest; (iii) a report of such effort along with certain additional information (including the details of the effort made to explore the floor and the extent of the specialist's interest), must be made to a floor governor prior to soliciting third market interest; (iv) a reoffering of the transaction must be made on the floor after any solicitation of third market interest to permit displacement by public orders represented in the crowd and on the specialist's book and by the specialist acting as dealer if the specialist advised the member of his interest prior to solicitation of the third market maker; and (v) a subsequent report must be made of the particulars of the off-board transaction. The rule has been interpreted to require members wishing to effect agency trades off-board to disclose the size and side of the market of their customers' orders to the specialist during the course of exploring the floor.[17] Off-board principal trades (with certain exceptions) require permission in each case.

Amex Rule 5 provides that a member may execute a transaction off-board either as principal or agent only if the exchange member has obtained the prior permission of the exchange. The Commission understands that the Amex will approve a transaction by a member as principal or as agent for a customer if the member can "reasonably demonstrate" that a better execution can be obtained. The Amex staff weighs the request in terms of the character of the market, the price and size of the transaction and related factors; after a discussion of these facts with a floor official, the request will be granted "if the Exchange is satisfied, in each instance, that the transaction can be executed more advantageously off the Exchange." Assuming compliance with this Amex procedure results in permission for an off-floor transaction, that permission is conditioned on satisfying certain orders on the specialist's book, and interest by the specialist and other floor professionals.

Regional exchange off-board trading rules generally require (either explicitly or by interpretation) no more than that agency or principal orders to be effected off-board be bid for or offered orally on

See footnotes at end of document.

the exchange floor and yield priority to limit orders and (under certain circumstances) to specialist orders.[18]

B. EFFECTS OF EXISTING OFF-BOARD TRADING RULES ON COMPETITION

As described in the September Report and the Appendices thereto and at the October Hearings, and as more fully discussed below, exchange off-board trading rules effectively compel transactions in listed securities by exchange members, as principal or as agent, to be executed on the floor of an exchange (even though such rules generally contain provisions prescribing a means by which such transactions, under special circumstances, may be effected over-the-counter). Thus, a member of an exchange (with exceptions pertaining to over-the-counter market maker members of certain exchanges and certain types of transactions exempted from the requirements of off-board trading rules by their terms)[19] acting as principal (i.e., buying or selling for his own account) is prevented from (i) making a *bona fide* continuous two-sided round-lot market over-the-counter; (ii) executing customers' orders as principal over-the-counter; (iii) "positioning" a portion of a large block (by acquiring stock for his own account) over-the-counter to facilitate a block trade; and (iv) acquiring or disposing of investment positions over-the-counter.

Similarly, a member of an exchange acting as agent (i.e., buying or selling for the account of another person) is barred from (i) effecting an over-the-counter transaction in a security listed or traded on the exchange for a customer directly with a third market maker or broker or an institutional buyer or seller; (ii) crossing both sides of a large block transaction, acting as agent for both, in-house, and (iii) crossing small retail orders, acting as agent for both sides, in-house.[20]

Notwithstanding the requirements of exchange off-board trading rules with respect to over-the-counter transactions, those rules in no way affect the ability of exchange members to effect transactions of the type described above, either as principal or as agent, on any exchange. Thus, a member of the NYSE, bound by the terms of NYSE Rule 394 in connection with any over-the-counter transaction, is not inhibited or impeded by that rule in effecting transactions (whether as a specialist, as a block trader, or in any other principal or agency capacity) on, for example, the Midwest, Pacific or Cincinnati Stock Exchanges.[21] Since one of the primary justifications advanced by each exchange for retention of its off-board trading rules (in one form or another) is the need to afford priority and execution protection to various categories of buying or selling interest represented on the floor of that exchange (i.e., public limited price orders entered on the specialist's book, public orders represented in the "crowd," orders for the specialist's own account, and orders for the accounts of other members), the existing ability of exchange members to avoid exposure to and displacement by such interest on the floor of any particular exchange (e.g., the NYSE) by choosing among exchanges the one best suited to the member's purposes for an execution is of special significance and raises serious questions of fairness and equality of opportunity with respect to competing markets, competing market makers, competing brokers and competing customers (both retail and institutional).

In the present environment, competition among market makers in exchange-listed, multiple-traded securities is imperfect for a number of reasons, not the least of which is the effects of exchange off-board trading rules. Because of exchance off-board trading rules, over-the-counter market makers are unable, as a practical matter, to compete effectively with exchange specialists in attracting those orders: competition between over-the-counter market makers and exchange specialists is distorted by the captive nature of agency orders represented by exchange members. In addition, members of exchanges which otherwise would be willing to devote their financial resources and skills to over-the-counter market making in exchange-listed securities are prevented from doing so. Thus, exchange markets and exchange specialists enjoy, in large part as a consequence of off-board trading rules, important competitive advantages over the third market and over-the-counter market makers, respectively.[22]

Off-board trading rules also interfere with the fairness of competition among brokers and among customers. Exchange members acting as brokers, for example, are limited to exchange markets in seeking executions for their customers, while nonmember brokers are not. Nonmember brokers, of course, must pay commissions to exchange members or otherwise compensate them in order to obtain access to exchange markets. In addition, exchange member brokers are prevented from realizing such efficiencies from the in-house crossing of orders (large and small) as that method of doing business may entail.[23] Discrimination among customers is a direct product of off-board trading rules for several reasons. First, those rules have the effect of limiting opportunities for execution of "not held" and "market" orders in order to subordinate the interests of customers having such orders to those of the market place at large, and particularly to those of customers which enter limited price orders in the specialist's book. Second, while institutions may direct orders to over-the-counter market makers or to an exchange market for execution, relatively modest orders of smaller customers are confined to exchange markets because of restrictions placed upon members of the "primary" exchanges (who represent the great majority of noninstitutional customers).

C. RELEVANT REGULATORY OBJECTIVES OF THE SECURITIES ACTS AMENDMENTS OF 1975

A major underlying basis for the Securities Acts Amendments of 1975 was the view of Congress that "because of excessive and unnecessary regulatory restraints, competition in the securities industry has not been as vigorous and as effective in advancing the public interest as it could be." [24] The Congress, therefore, made pervasive changes throughout the Act "to charge the Commission with an explicit obligation to eliminate all present and future competitive restraints that cannot be justified by the purposes of the Exchange Act." [25]

In addition, Congress determined that the secondary trading markets for securities "could be substantially improved by the prompt development and implementation of a central or national market system." [26] In this regard, Congress described the legislation thus:

> The bill approaches the problem of encouraging the development and implementation of a national market system from the point of view of preserving the competing markets for securities that have developed, breaking down all barriers to competition that do not serve a valid regulatory purpose, and encouraging maximum reliance on communication and data processing equipment consistent with justifiable costs.[27]

The Congressional commitment to a national market system is reflected in an amendment to the list of regulatory purposes of the Act enumerated in section 2:

> [T]ransactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary * * * to remove impediments to and perfect the mechanism of a national market system for securities * * *.

In addition, section 11A(a)(2) [28] expressly directs the Commission to use its authority under the Act to facilitate the development of a national market system in accordance with the findings and objectives of section 11A(a)(1).[29]

The Congress determined, however, that, because the nations' securities markets are in dynamic change and in some respects are delicate mechanisms, the Congress should establish a statutory scheme which explicitly granted the Commission broad flexibility and authority to oversee the implementation of a national market system in accordance with the enumerated broad goals and objectives.[30] In so doing the Congress stressed the importance of maximum reliance on economic forces and enhancement of competition in furthering the evolutionary development of a national market system and in achieving the goals and principles enunciated in section 11A. The Senate Committee stated this philosophy in its Report as follows:

> In 1936, this Committee pointed out that a major responsibility of the SEC in the administration of the securities laws is to "create a fair field of competition." This responsibility continues today. The bill would more clearly identify this responsibility and clarify and strengthen the SEC's authority to carry it out. The objective would be to enhance competition and to allow economic forces, interacting within a fair regulatory field, to arrive at appropriate variations in practices and services. It would obviously be contrary to this purpose to compel elimina-

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tion of differences between types of markets or types of firms that might be competition-enhancing.[31]

In addition, to aid the Commission in discharging its responsibilities and obligations under the Act, and to smooth the development of a national market system, Congress determined to establish a National Market Advisory Board.[32] One of the primary functions of the Board is to study and make recommendations to the Commission as to the steps it finds appropriate to facilitate the establishment of a national market system.[33] The Board is also charged with a responsibility to furnish the Commission its views on significant regulatory proposals made by the Commission concerning the establishment, operation and regulation of the securities markets.[34]

While Congress imposed the duty generally on the Commission to eliminate anti-competitive restraints not necessary or appropriate, in furtherance of the purposes of the Act, and while Congress charged the Commission with achieving the broad objectives of a national market system, it nevertheless determined to single out off-board trading rules of exchanges for immediate consideration. Thus, section 11A(c)(4)(A) of the Act compels the Commission to determine whether existing exchange off-board trading rules impose burdens on competition and, if so, whether such rules appear to the Commission to be necessary or appropriate in furtherance of the purposes of the Act, and to do so within a specified statutory time frame. The standards of the Act against which off-board trading restrictions are to be measured were enumerated by the Commission in its September Report, namely:

(1) The protection of investors;[35]

(2) The maintenance of fair and orderly markets;[36]
markets;[36]

(3) The removal of impediments to, and the perfection of a mechanism for, a national market system for securities;[37]

(4) Fair competition among brokers and dealers, among exchange markets, and between exchange markets, and markets other than exchange markets;[38]

(5) Prevention of unfair discrimination between customers, between brokers and between dealers;[39]

(6) The practicability of brokers executing investors' orders in the best market;[40]

(7) Economically efficient execution of securities transactions;[41] and

(8) An opportunity, consistent with the standards indicated in subparagraphs (6) and (7) above, for investors' orders to be executed without the participation of a dealer.[42]

There is something of a conflict, of course, between the objective of centralization of order flow with the other objective of acting now to enhance competition among market makers by eliminating or amending off-board trading rules. The inherent conflict between these otherwise antithetical goals can only be reconciled fully when a national market system has been achieved. Thus, while the Commission must give great weight to the findings and conclusions of Congress in section 11A, it must also attempt to balance and weigh these goals to achieve the maximum accommodation possible under the imperfect circumstances which exist today.

Congress attempted to provide some guidance in balancing certain of the goals which were perceived to have a potential for conflict. S. 249, as introduced in January, 1975, did not suggest any priorities in the list of goals enumerated in section 11A(a)(1)(C), but it was later revised, apparently in response to comments, to resolve the inherent tension perceived between two of the enumerated objectives: (a) Assuring economically efficient execution of securities transactions and (b) assuring an opportunity for investors' orders to meet without intervention of a dealer. The Senate Report described the resolution thus:

> [I]t is in the public interest to assure * * * an opportunity for investor orders to be executed without the intervention of a dealer, so long as such opportunity would be consistent with an economically efficient mechanism for the execution of transactions * * *[43]

In addition, the Committee on Conference, without comment or elaboration, further conditioned the objective of execution without intervention of a dealer on the goal of assuring the practicability of brokers executing investors' orders in the best market. Thus, an opportunity for investors' orders to meet without the intervention of a dealer is an important goal of the Act, but only when it may be achieved in a manner consistent with the economically efficient execution of securities transactions and the practicability of brokers executing investors' orders in the best market.

Further, it is important to note that, despite the pervasive changes made in the statute to require the Commission to consider and weigh the competitive consequences of all its decisions, Congress specifically did not require adoption of the least anti-competitive alternative available. The Senate Committee described the interaction of the statutory purposes as follows:

> This explicit obligation to balance, against other regulatory criteria and considerations, the competitive implications of self-regulatory and Commission action should not be viewed as requiring the Commission to justify that such actions be the least anti-competitive manner of achieving a regulatory objective. Rather, the Commission's obligation is to weigh competitive impact in reaching regulatory conclusions. The manner in which it does so is to be subjected to judicial scrutiny upon review in the same fashion as are other Commission determinations, with no less deference to the Commission's expertise than is the case in other matters subject to its jurisdiction.[44]

Finally, in its deliberations on off-board trading rules of exchanges, the Commission has been cognizant of other important statutory goals not enumerated in section 11A. Overriding purposes of the Act, for example, since its enactment in 1934, have been the protection of investors[45] and the maintenance of fair[46] and orderly[47] markets.[48] In addition, the Securities Acts Amendments of 1975 reflect the Congressional determination that rules of self-regulatory organizations may not be designed to permit "unfair discrimination between customers, issuers, brokers or dealers."[49]

In sum, therefore, while the Act requires the Commission to take action immediately with respect to off-board trading rules, to enhance competition in the markets in accordance with the goals of the Act, that action must be fashioned in such a way as to ensure the most rapid possible progress toward achievement of a national market system. Substantial changes already have been made in the structure of the markets in accordance with the objectives of a national market system and the Commission intends to utilize its new powers under the Act to facilitate implementation of that system to the fullest extent necessary to ensure its realization. Thus, for example, as discussed below, it appears necessary at this time to promote rapid development of a central electronic depository for limited price orders (a "composite book") to ensure integration of the markets in an environment of significantly enhanced competition among market makers, nationwide protection for limit orders and augmentation of existing opportunities for public orders to meet without the participation of a dealer.

In this regard, the newly created National Market Advisory Board will be expected to provide valuable aid in counselling the Commission on ways to monitor the consequences of its off-board trading rules decision and to facilitate development of the composite book.

D. PROPOSALS TO AMEND OFF-BOARD TRADING RULES

During the course of the Commission's proceeding the Commission has considered a wide range of possible amendments to such rules, including those proposed by the Commission in its September Report, and those suggested by commentators and witnesses at the October Hearings.

(1) *Commission's proposed rules.* The Commission's proposed substitute off-board trading rules, proposed Rules 19c–1 [A], [B] and [C], each contain certain optional language to illustrate the varying effects which such a rule, if adopted, could have on the ability of members, under various circumstances, to effect a trade otherwise than on an exchange.

Proposed Rule 19c–1[A] would abrogate all restrictions on both off-board principal transactions and off-board agency transactions. Alternatively, the rule would remove only off-board agency restrictions.

Proposed Rule 19c–1[B] would provide that a member, prior to executing an over-the-counter transaction (or, alternatively, over-the-counter or on another exchange) for his own account or the account of a customer at a price equal to or better than the exchange quotation,

See footnotes at end of document.

would be required only to make such inquiry of the exchange floor as the member deemed appropriate under the circumstances (including use of a quotation display device). If, however, the proposed off-board transaction price would be inferior to the price quoted on the exchange, the proposed rule would require the exchange member first to inquire of the specialist to ascertain the extent to which limited price orders on the specialist's book were available to satisfy the order, and then to satisfy all such limit orders at better prices than the off-board price either before, simultaneously with, or immediately after the off-board execution.

Proposed Rule 19c-1[C] is similar to proposed Rule 19c-1[B] in many respects. Rule 19c-1[C], however, would impose an obligation to make at least such inquiry of the exchange floor as may be necessary to form a belief that a better price could be obtained off-board even if the off-board transaction price would be superior to the exchange quotation. Additionally, Rule 19c-1[C] would require that, in the event an equal or better price exists for part of the order on the exchange, public orders on the book and in the "crowd" at an equal price, and member orders at a better price, be filled either before, simultaneously with, or immediately after the off-board execution. Rule 19c-1[C] also contains an optional "gapping" provision which would permit an exchange to require that public limit orders required to be satisfied under the rule be filled at the off-board execution price rather than at the price bid or offered on the exchange.

(2) *Alternative proposals.* The alternative uniform off-board trading rules suggested by commentators and witnesses at the October Hearings include the following:

(a) *NYSE market responsibility rule.* In conjunction with its testimony on October 20, 1975, the NYSE introduced a proposed rule, the Market Responsibility Rule ("MRR"), later filed pursuant to section 19(b) of the Act and Rule 19b-4 thereunder, to replace the NYSE Rule 394.[50] The MRR would continue to require that all principal and agency trades by members take place on the NYSE floor, except as otherwise specifically permitted.

The MRR would provide that a member holding a customer's order could solicit or be solicited by a non-member dealer for the execution of that order at any time. If the exchange member believed that a better execution could be obtained over-the-counter, so long as, immediately before effecting the trade off-board, the broker ensured that (i) all public orders entered on the specialist's book or in the "crowd" at the same or better prices than the off-board transaction price were satisfied at the off-board transaction price; and (ii) all orders for the accounts of members (including specialists) at better prices than the off-board transaction price were satisfied at the prices bid or offered by them. In addition, a complete report of all aspects of each such transaction would be required by the end of the next trading day. With respect to off-board principal transactions, the MRR would establish a flat prohibition, subject to a number of exceptions.[51] In effect, the MRR would always permit the NYSE specialist the last opportunity to better any third market bid or offer.

(b) *Association for the preservation of the auction market rule.* The Association for the Preservation of the Auction Market introduced a proposed rule (the "APAM rule") during the course of the October Hearings similar in many respects to the NYSE's MRR.[52] The APAM rule was proposed as a model uniform rule for all exchanges. While the MRR would permit a dual member to take an agency order to the over-the-counter market only after satisfying the off-board trading rules of all exchanges to which that member belongs and all public and member orders on the NYSE entitled to displace the order, as indicated above, the APAM rule would require such a member of any exchange to fill the prescribed categories of orders only on one exchange having a "reasonable" order flow. Unlike the MRR, however, specialists and exchange members would be required only to equal the proposed off-board transaction price in order to participate in the transaction rather than to better that off-board price. The APAM rule would not affect existing off-board principal transaction restrictions.

(c) *Securities Industry Association Rule.* The Securities Industry Association proposed a rule[53] which would require a member broker wishing to execute an agency order off-board at a price between the exchange quotation to physically check both the specialist and the crowd at the specialist's post and satisfy any public orders entered on the specialist's book or represented in the "crowd" at the same or better prices than the off-board transaction price prior to effecting an off-board trade. A similar requirement would be imposed in the case of an order to be executed off-board at a price equal to or inferior to the exchange quotation, but, in that event, orders for members' own accounts (including those of specialists) also would have to be satisfied at prices better than the off-board transaction price. Like the MRR and existing NYSE Rule 394, disclosure of the order (including its approximate size and the size of the market) would have to be made to the specialist. Principal transactions woud remain restricted as they are today.

(d) *Midwest Stock Exchange Rule.* During the October Hearings, the Midwest Stock Exchange also proposed a uniform rule (the "MSE rule") with respect to off-board agency transactions.[54] The MSE rule would permit off-board execution of agency transactions so long as a member believes, in the exercise of reasonable judgment, that such an execution could result in a more favorable price for his customer. Exchanges could require, moreover, either before, simultaneously with, or immediately after an off-board agency transaction, that public bids or offers entered on the specialist's book at the same or better price than the off-board transaction price be satisfied. No other category of orders could be similarly required to be satisfied. In addition, the MSE rule would provide that public limit orders entered on the specialist's book could be required to be "gapped"—that is, filled at the off-board transaction price—and that a report of the characteristics of and parties to any off-board trade after it is executed be provided to that exchange.

Most of the foregoing proposed off-board trading rules have features in common with existing off-board trading rules. The following analysis of the effects of various exchange restrictions on off-board principal and agency transactions, therefore, is equally applicable to those proposals and to existing rules.

III. Analysis of Off-Board Trading Restrictions

A. Restrictions on Off-Board Principal Transactions

The Commission's September Report concluded that exchange off-board trading rules effectively prevent exchange members other than specialists from competing with specialists and over-the-counter market makers in the business of making two-sided, round lot markets in exchange-listed securities.[55] Off-board trading rules have this effect either because they prohibit members from executing principal transactions over-the-counter without, in each case, obtaining prior permission from an exchange official (e.g., NYSE Rule 394(a), which explicitly requires permission) or because they require members, as a prerequisite to effecting any off-board principal transaction, to yield priority to other orders on the exchange floor (e.g., Rule 9 of Article XVIII of the Rules of the Midwest Stock Exchange, requiring that orders to be effected off-board must be "made available" to the regular membership prior to the off-board trade) or to comply with other procedures which may preclude achievement of an economical over-the-counter execution (e.g., Rule XIII of the Pacific Stock Exchange, requiring that "an equal bid or offer is made * * * on both Trading Floors of the Exchange").[56]

Consequently, as presently constituted, off-board trading rules deprive the securities markets of the benefits which might otherwise accrue from enhancement of competition among market makers and the commitment of additional capital and professional skill to the market making function. In addition, these rules prevent exchange members from executing their customers' orders in-house as principal. This might be done by simply filling customers' orders from inventory accumulated as a result of market making or otherwise, thus internalizing the "jobber's turn" inherent in most transactions, or by acting on a "riskless principal" basis. The rules also preclude members from executing orders periodically for their own ac-

See footnotes at end of document.

counts off-board with third market-makers or with institutions, either for investment purposes or in connection with positioning a portion of a larger block transaction.

It is apparent to the Commission that rules which represent, as these rules do, impediments to "fair markets and markets other than exchanges," cannot be permitted to remain in effect. The question for the Commission now is to decide how best to provide for the elimination of these impediments to competition in a manner that is complementary to the development of the national market system and in an orderly manner which is "fair" to public investors and others.

Increased competition among market makers can yield a number of significant benefits to the markets. For example, competitive forces can assume much of the burden of disciplining market maker behavior. In an environment characterized by the real-time public reporting of all completed transactions on a continuous basis (by means of the consolidated transaction reporting system implemented pursuant to Rule 17a–15 under the Act[57]), market forces can contribute substantially to the reasonableness of market makers' quotations in relation to last sale prices.[58]

In addition, each market maker's bids and offers would have to be competitive in terms of price and size compared to the prices and sizes of other market makers' bids and offers in order to ensure a regular flow of order inquiry; failure to maintain a competitively priced market of reasonable depth would be penalized by a loss of orders (without which a market maker has no consistent opportunity to make a "jobber's turn," the basis of his profit).[59] Spreads, the differences between market makers' bid and asked prices, should be narrowed as the bids and offers of various market makers compete with each other to attract order flow and opportunities to achieve executions.[60] Market makers generally would conduct their activities on a regular and continuous basis (rather than sporadically) for the same reason: brokerage inquiry is unlikely to be directed to market makers who do not regularly perform their functions.[61]

The absence of effective market maker competition in the past has required the Commission and the self-regulatory organizations to attempt, by regulatory means, to define standards of performance for certain market makers with respect to depth, liquidity and continuity.[62] Such regulatory efforts have not been entirely successful. Moreover, rules specifying market making standards have not been susceptible to objective or effective enforcement.[63] The Commission believes that replacement of these rules by the more compelling forces of competition should result in substantial improvements in the quality of market making generally and the fairness of competition among market makers.

Thus, it would appear that the perfection of competition among market makers offers the greatest promise of maximizing the depth and liquidity of the securities markets considered as a whole, under circumstances requiring the least interference by governmental or quasi-governmental bodies in the market making process.

It has been urged that the beneficial effects of an increase in market maker competition, stimulated by the entry of non-specialist exchange members into the business of market making, could be realized immediately by eliminating exchange rules which proscribe or inhibit off-board principal transactions.[64] Those espousing this view believe that, if over-the-counter round-lot market making were permitted, institutional traders and brokerage firms would have every incentive to encourage securities information processors (especially vendors of market information) and existing market centers to improve existing communications systems rapidly to ensure access to, and knowledge of, the activities of all significant centers of market making activity.[65]

Elimination of restrictions on the ability of exchange members to effect principal transactions off-board otherwise than as *bona fide* market makers would not result in the significant benefits to the markets referred to above. Such action, however, would permit individual firms, under appropriate circumstances, to effect transactions away from the exchange market, where they believe that this would facilitate block positioning, or would realize cost savings or other benefits.

Others, however, have asserted that abrogation of exchange off-board trading rules governing principal transactions under present circumstances would lead to a significant loss of order flow by the "principal" exchange markets (i.e., the NYSE and Amex),[66] disrupt the markets considered as a whole (impeding their fair and orderly functioning),[67] would expose securities customers (especially relatively small and unsophisticated customers) of retail firms electing to engage in market making to significant new risks,[68] would engender unfair competition among market makers,[69] would undermine the effectiveness of exchange market surveillance systems,[70] would competitively disadvantage member firms which lack adequate resources to engage in market making, and would lead to inequality among exchange members in terms of execution costs and ability to participate in the flow of orders currently centralized on exchange floors.[71]

Of particular concern to the Commission is the widely held belief, enunciated at the Commission's October Hearings and earlier, that abrogation of exchange restrictions on off-board principal transactions, by encouraging over-the-counter market making by member firms, would contribute to fragmentation of the securities markets, would expose customers of those firms to over-reaching in such dealings, and would lead to unfair competition among different categories of market makers.[72]

Other arguments presented at the October Hearings with respect to the dangers inherent in abrogating off-board trading rules governing principal transactions were less compelling. For example, mere loss of order flow by any particular market center to other existing market centers would not, by itself, appear to justify retention of off-board trading rules governing principal transactions. That development could occur today without any change in exchange off-board trading rules. As indicated in the September Report, exchange off-board trading rules do not prevent exchange members from effecting transactions in NYSE-listed securities freely on other exchanges trading those securities, either as principal or agent. Thus, if there were compelling economic or other reasons for doing so, members of the NYSE which also are members of regional exchanges could readily transport the bulk of the NYSE's existing order flow to other exchanges, and could engage in market making in NYSE-listed securities on other exchanges, without violating any rule of the NYSE.[73]

Similarly, it is difficult to see why a well-capitalized firm should be prevented from engaging in the capital intensive business of market making simply because other firms lack the capital to do so. This kind of conduct has never been thought to constitute "unfair" competition and does not warrant retention of exchange restrictions on off-board principal transactions. With respect to the assertion that action to abrogate exchange off-board trading rules would result in a loss of exchange surveillance capacity, it is unclear that over-the-counter transactions are intrinsically more difficult to monitor than exchange transactions. The most important benefits of exchange surveillance are derived from the application of computerized monitoring techniques to member-firm trading and general market activity (e.g., to detect unusually aggressive buying or selling and to identify the source of that activity). These activities could be monitored regardless of the market in which they occur. In addition, recordkeeping and reporting requirements (e.g., time-stamping and retaining records of orders) may be applied to exchange members regardless of which markets are used to achieve executions. Similar considerations would apply to the monitoring of over-the-counter market making by members if that conduct were permitted.

It has been asserted[74] that centralization of the great majority of orders in "primary" exchange-listed securities on such exchanges has afforded a mechanism whereby all members of such exchanges, large and small, may execute agency orders on a relatively equal basis in terms of costs and exposure to execution opportunities.

This observation, however, must be qualified in certain important respects. The amount and kind of orders represented by various firms, and the economic power which accompanies a substantial brokerage business, may well affect the ability of such firms to elicit

See footnotes at end of document.

cooperation from specialists and may result in differences in treatment, at least with respect to sizable orders. In addition, differences in treatment may result from the specialist's perception of the degree to which a particular brokerage firm cooperates with the specialists by disclosing the extent of customers' buying and selling interest and by taking into account the specialist's interests in acquiring or disposing of long or short positions.

Finally, it has never been possible for each firm (regardless of type, size, capital and geographic location) to obtain equal exposure, in terms of an opportunity to achieve executions, to the order flow represented by all buyers and sellers present in the markets at any particular time: specialists on primary exchanges, specialists on regional exchanges, floor brokers, and firms which are not members of any exchange, for example, have never been equally favored in this respect. Thus, some firms would lose relatively advantageous positions in terms of exposure to the bulk of national order flow while others would improve their positions in that regard as a consequence of any reallocation of existing orders among competing market centers (whether presently existing or newly created).

Minimization of differences among firms in terms of exposure to all buying and selling interest is one of the prime objectives of a national market system, and it would appear that only a national market system, with a comprehensive national communications network as its core, can capture and reflect all such interest in a non-discriminatory manner. Perpetuation of off-board trading rules would not achieve this result.

In any event, the "primary" exchanges are only two among a number of competing markets (however dominant their positions may be), and the benefits to "primary" exchange members engendered by off-board trading rules must be balanced against corresponding disadvantages to the markets, considered as a whole, which may result from those rules.[75] In this context it should be noted that a significant segment of the securities industry, including both "primary" exchange members and others, do not have an opportunity to engage in market making activities under circumstances affording exposure to "primary" exchange order flow (and thus cannot bring additional market making capability to bear where public order flow is greatest).

The threat of further fragmentation of the markets and internalization of order flow by exchange members engaged in market making is far more serious. Such fragmentation, it is claimed, would occur because a number of the largest, best capitalized member firms could seize the opportunity to make regular two-sided over-the-counter markets in the most actively traded exchange-listed securities, withdrawing the major portion of their order flow from exchanges while retaining their memberships (in order, for example, to "lay off" positions acquired in the process of market making in an efficient economical manner). This opportunity would be attractive to such firms because of the profit potential inherent in internalizing the "jobber's turn" otherwise surrendered to a specialist.

Similarly, the availability of "jobber's turn" profits might encourage exchange members to attempt to internalize customers' orders and execute them as principal, perhaps electing to deal only with such customers. In that event, rather than dealing with customers at prices established in the course of making a *bona fide* continuous two-sided market (where the firm assumes risks in acquiring long and short positions), the firm would execute customers' orders to buy and sell at prices based upon the firm's ability to offset its position immediately, as principal, against other orders, charging a differential or mark-up sufficient to generate a profit.

These arguments assume that customers in fact would continue to transmit their orders directly to such firms, ensuring a continuity of a substantial flow of orders (a prerequiste to either profiable market making or the conduct of a regular "riskless principal" business, even though those orders would be effected on a principal rather than on an agency basis.[76]

Whether retail member firms would attempt to internalize their order flows, and whether they would succeed if they did attempt to do so, may be questioned. If such a development occurred on a widespread basis, it is by no means clear (particularly in view of the consolidated transaction reporting system and the potential development of quotation systems for listed securities) that individual investors would fail to appreciate the value of an agent's services or to recognize the dangers inherent in pitting themselves directly against the skill and knowledge of professional dealers. However, should such internalization of orders occur under existing circumstances, it would contribute to the fragmentation of markets and could require, at a minimum, Commission action to protect public customers of retail firms engaged in market making from overreaching.[77]

Even if customers of retail firms electing to commence market making over-the-counter were protected against overreaching, other problems might be generated by further fragmentation of today's markets. For example, without a communications tool such as a composite quotation system, reflecting firm bids and offers by all market makers, a substantial diminution of order flow presently concentrated in existing market centers could reduce, rather than increase, opportunities for the economically efficient execution of transactions.[78] Rapid awareness by market makers and brokers of all market makers' quotations is a prerequisite to the kind of competitive interaction which guarantees achievement of the benefits expected of "fair competition" among market makers.[79] In addition, brokers need a tool such as a composite quotation system to make informed judgments in selecting a market for execution of customers' orders.[80]

Broad dissemination of quotations from competing market makers can be achieved promptly. It must be stressed here, however, that these inadequacies of communication can be overcome. The industry can and must, in its own interest, work diligently together to develop a composite quotation system swiftly in response to increased competition in market making. Securities information processors would derive increased revenues from new or improved quotation communications devices utilized by brokers. New and existing market makers would be anxious to gain the broadest publicity for their activities and to demonstrate, on a national basis, the competitiveness and strength of the markets made by them. Brokers would benefit in terms of increased capacity to serve their customers and by obtaining equal access to crucial information as to the prices at which their customers' orders may be filled throughout the nation.

As indicated above, abrogation of exchange rules governing off-board principal transactions would also permit firms to position, for their own accounts, portions of large blocks in-house and to acquire or dispose of investment positions directly in the over-the-counter market without bringing those transactions to the floor of any exchange and exposing them to displacement by one or more categories of buying or selling interest in accordance with the rules of that exchange. However, as noted below, block transactions today may be effected on a regional exchange where the executing firm has reason to believe the trade will not be "broken" by the intrusion of other buying and selling interest if that result is important to completion of the trade. Similarly, if an exchange member wishes to acquire a portion of the block for his own account without having to satisfy other interest on the floor of the "primary" exchange market, that, too, can be accomplished today by taking the transaction to a relatively inactive regional exchange for execution.

For the same reasons, and by means of the same technique, members effectively may acquire or dispose of investment positions under existing circumstances without regard to other buying and selling interest on the "primary" exchange market. While elimination of off-board principal restrictions would appear to lessen the cost of such conduct, preservations of those restrictions would do little to prevent firms from engaging in it.

Development of a central electronic repository for limited price orders would be of special significance to ensure integration of the markets and preservation of an opportunity for public orders to meet without the participation of a dealer. Such a step will certainly enhance competitive opportunities in market making.[81] For all these reasons, the Commission will utilize its new powers under the Act promptly to ensure implementation of a national mechanism for multi-market protection of limit orders.[82]

See footnotes at end of document.

Nevertheless, it must be emphasized that it would be inappropriate to withhold from the markets the benefits to be derived from increased market maker competition indefinitely. Development of a national limit order mechanism is a further step in creating a national market system and must be expedited.

Finally, it must be acknowledged that the existing scheme of market maker regulation embodied in certain Commission rules,[83] intended to govern specialist behavior, does burden certain market makers while not affecting others. Careful consideration must be given, therefore, to elimination or modification of these rules when a definite date is set for the elimination of exchange barriers to the commencement of over-the-counter two-sided market making in round lots by member firms.

Obvious candidates for elimination or modification in the context of new opportunities for over-the-counter market making are rules such as NYSE Rule 113 and Amex Rule 190 which prevent specialists from dealing directly with institutional customers,[84] and regulatory provisions which impose so-called "affirmative obligations" on specialists.[85] With respect to exchange bars against direct specialist dealings with institutions, the potential for abuse to which those exchange restrictions were addressed (e.g., manipulation of the market price to benefit a large customer and other kinds of customer favoritism) would be reduced and perhaps negated by more effective competition among market makers and loss of the "primary" exchange specialist's monopolistic position.

Similarly, except for providing "continuity" (which is objectively measurable), specialists' other "affirmative obligations" to provide "liquidity" and "depth" (which are not objectively measurable) have not been demonstrated to force a specialist, as a general matter, to act against what he perceives to be his interest: rather, it would seem that a more powerful motivation (particularly in the context of enhanced competition among market makers) is the specialist's desire to demonstrate his willingness and capacity to make a continuous and relatively stable market and his fear of losing order inquiries if he fails to demonstrate those characteristics.[86]

The need for certain other regulatory strictures affecting specialists[87] in a competitive environment also may be questioned, particularly after implementation of a central electronic limit order repository.

Weighing the potential disadvantages to the markets against the potential advantages which the Commission anticipates would result from elimination of exchange rules preventing or impeding the execution of principal transactions off-board, the Commission presently is of the view that, under appropriate circumstances, increased ability to engage in over-the-counter market making in listed securities by a larger segment of the broker-dealer community (whether by existing exchange members or others), with exposure to order flow, is more likely to improve the securities markets than injure them. In addition, the Commission is convinced that the risks inherent in abrogating exchange restrictions on off-board principal transactions at the present time could be minimized by the prompt achievement of additional elements of a national market system. These elements include, particularly: development of a central electronic repository for limited price orders (a "composite book"), coupled with Commission rules requiring public orders entered in that book having price or time priority to be filled prior to the execution of any other transaction by a dealer, implementation of a composite quotation system (reflecting bids and offers by market makers, and, perhaps, indications of buying or selling interest by brokers themselves), and development and implementation of facilities for ensuring that customers are receiving the best executions available in the system.[88]

In light of the above considerations, the Commission believes it appropriate to devote additional study to the consequences of over-the-counter market making as it might develop when exchange off-board trading restrictions governing principal transactions are removed, and to afford an opportunity to the newly created National Market Advisory Board to consider those consequences, before taking final action to remove exchange rules governing off-board principal transactions.[89] In addition, the Commission needs additional time to develop and propose such new rules (and to eliminate such existing rules) as may be necessary or appropriate in the context of an environment permitting off-board market making by retail firms.

Finally, the Commission believes that the self-regulatory organizations and the securities industry in general should be afforded additional time to take steps to ensure the prompt development of a composite quotation system, a composite book and facilities for the routing and execution of orders and to consider whether changes should be made in existing self-regulatory organization rules coincident with establishment of a more competitive environment for market making.[90] For these reasons, the Commission has determined that, insofar as existing exchange rules prevent or impede exchange members from effecting principal transactions in exchange listed securities in the over-the-counter market, such rules should be retained for the present time.[91]

The Commission will reconsider this decision no later than March 1, 1977, after it has had the benefit of the conclusions and advice of the National Market Advisory Board and progress by that date toward establishment of a national market system, and, if it still appears appropriate, will establish a firm date for elimination of exchange rules governing off-board principal transactions, after which over-the-counter market making by member firms will be permitted. We wish to emphasize again that by that date the Commission will have had an opportunity to consider the views and recommendations of the National Market Advisory Board (and others) with respect to the most effective manner in which "fair competition" among market makers may be achieved in the context of an evolving national market system.

The Commission further recognizes that, depending upon further developments, it may prove appropriate to permit *bona fide* two-sided market making off-board by exchange members prior to removing all restrictions upon off-board principal transactions by such members. The Commission, however, does not intend to imply that it has determined to tie abrogation of off-board trading rules governing principal transactions to the achievement of any particular elements of a national market system. Rather, in view of the potential advantages and disadvantages which may flow from such action, the Commission merely wishes to afford those who will be most directly affected by removal of existing prohibitions an opportunity to take prompt steps to develop the mechanism which almost all agree would minimize or eliminate the adverse consequences which might arise.

B. RESTRICTIONS ON OFF-BOARD AGENCY TRANSACTIONS

The Commission's September Report concluded that existing exchange off-board trading rules governing agency transactions effectively prevent over-the-counter market makers from competing with exchange specialists for agency orders entrusted to exchange members for execution.[92] By functionally preventing over-the-counter market makers from obtaining direct access to the flow of agency orders commanded by exchange members (and access by exchange members, as agents, to markets made over-the-counter), these off-board trading rules constrain exchange members, acting as agents, from freely exercising their professional judgment in seeking the most favorable opportunities for execution of their customers' orders, thereby inflicting a significant competitive disadvantage on over-the-counter market makers as well as exchange firms which might seek to utilize markets off the floor of an exchange.[93]

In addition, by preventing brokers representing customers' "not-held" and "market" orders from attempting to execute those orders in the third market (when the third market, in the broker's judgment, offers the most favorable price to the customer), such rules also disadvantage customers by subordinating their interests to those of other customers who have placed limited price orders with a specialist or have given "not-held" or "market" orders to brokers and of exchange members bidding or offering for their own accounts on the floor of an exchange.[94]

Finally, such rules prevent firms having the opportunity to cross small orders in-house (because of a substantial flow of agency orders) or to cross large block transactions in-house (because of their

See footnotes at end of document.

reputations as block traders) to realize such cost savings and other efficiencies as they believe such conduct would afford and to afford an additional means by which their customers may meet at prices between prevailing market maker quotations.

While existing off-board trading rules of the various exchanges differ, as do those rules proposed by commentators at the Commission's October Hearings, in the degree to which, and the manner in which, they inhibit the ability of members to execute customers' orders in the third market,[95] they share, as an essential feature, the requirement that a member must first explore the market on the exchange floor, at least to obtain a current quotation from the specialist (currently possible only by going to the specialist's post).[96] Having compelled the broker, as an initial matter, to take his customer's order to the exchange floor, exchange requirements vary in granting priority over that order to various categories of buying and selling interest represented on the floor, i.e., to public limit orders entered on the specialist's book, public orders represented in the "crowd," orders for the specialist's own account, and orders by other members for their own accounts.

Thus, such rules generally require one or more of the enumerated categories of orders to be filled at prices equal to or better than the contemplated off-board transaction price a prerequisite to execution of any portion of a customer's order off-board.[97]

Virtually none of the witnesses appearing at the October Hearings (and none of the persons submitting comments to the Commission in response to its invitations)[98] suggested that exchange members, acting as brokers, should be foreclosed from dealing with an over-the-counter market maker in the event a better price could be obtained for a customer by so doing.[99] But many witnesses and commentators stated that, to some degree, exchange members seeking to effect agency orders in the third market should first be required to explore the possibility of obtaining a satisfactory exchange execution (and, in the process, to yield priority to one or more categories of orders represented on an exchange floor) as a prerequisite to an over-the-counter execution.

While expressing this view, no witness or commentator was able to formulate a satisfactory solution to the problem confronting a member of more than one exchange in choosing among exchanges to fulfill such an obligation.[100] All appear to agree that it would be impractical and inappropriate to require members of more than one exchange to fulfill such an obligation on each and every exchange to which they belong (and that the imposition of such a requirement in connection with a multiple exchange member's selection of an exchange market for execution of an order could well result in substantial harm to regional exchanges).[101] In spite of this apparently unresolvable conundrum, several commentators nevertheless suggested that objections to existing off-board trading rules could be overcome by amending them in a variety of ways, presumably in the hope that a solution to the so-called "multiple member" problem could be found.[102]

Proposals to amend exchange off-board trading rules ranged from the rules proposed by the Association for the Preservation of the Auction Market, Inc., and the NYSE to the relatively more liberal rule suggested by the Midwest Stock Exchange.[103] None of these proposals would free exchange members from an obligation to make actual inquiry of the market on an exchange floor and to yield priority in attempting a third market execution at least to limited price orders entered on a specialist's book.[104] Any of the proposals, therefore, if adopted, would represent burdens on competition between over-the-counter market makers and specialists and between different customers, and, to varying degrees, would impose restrictions on the exercise of brokerage judgment, in the manner described above. No similar barriers exist, of course, to selecting a particular market among exchange markets for execution of an agency order.[105]

The Commission has concluded that, even if a composite quotation system were available, a requirement that a member physically check the market at a specialist's post in itself would operate as a disincentive to consideration of third market execution opportunities by exchange members acting as agents because of the time, effort and expense involved in making that check (unless the order was large enough to justify such time, effort and expense). In concert with requirements that certain categories of orders on the exchange floor must be filled as a prerequisite to consummation of a third market agency trade (adding significantly to the costs of floor checking), this disincentive becomes so substantial as to preclude execution of most agency orders in the third market (at least those of relatively small size) even if such an execution would be more favorable to the customer than an exchange execution.[106]

It has been argued that off-board trading rules governing agency transactions do not, in fact, represent burdens on competition, and that, if they do, they serve necessary or appropriate regulatory purposes under the Act, thus justifying such burdens on competition as they do impose.[107]

With respect to whether off-board rules governing agency transactions actually do impose burdens on competition, certain commentators and witnesses at the October Hearings pointed out that members of the "primary" exchanges which are also members of one or more regional exchanges already have access to over-the-counter market makers which have joined certain regional exchanges as alternate specialists,[108] and that, in any event, exchange members now may execute agency orders on an exchange with over-the-counter market makers which are not exchange members without charging those market makers commissions.[109] These facts, it is asserted, demonstrate that off-board trading rules governing agency transactions do not impose any significant burdens on competition.

Nonetheless, as indicated in the September Report, not all "primary" exchange members belong to one of the regional exchanges having over-the-counter market makers as members, not all regional exchanges permit over-the-counter market makers to join and continue their over-the-counter activities, and not all over-the-counter market makers have become members of one of the exchanges which do permit continuation of over-the-counter market making by certain categories of members.[110] In addition, execution of transactions on a regional exchange could entail significant costs (e.g., communications, out-of-town clearing and order transmission expenses) the full extent of which might not have to be incurred if direct access to over-the-counter market makers was permitted.[111]

More significantly, in view of those costs, such transactions are practicable only to the extent that the size of the order (and the commission associated with its execution) justify transporting the order to a regional exchange.[112] Therefore, even with respect to over-the-counter market makers which are members of a regional exchange, exchange off-board trading rules effectively deny them the opportunity to compete directly for any portion of the flow of retail-size orders handled by exchange members, and unfairly impede them in competing directly for large orders, by disabling exchange members from taking advantage of potentially significant cost efficiencies inherent in direct over-the-counter executions.

The argument that exchange members now may execute agency orders with over-the-counter market makers on an exchange without charging that market maker a commission, thereby obtaining adequate access to such market makers' bids and offers, suffers from several defects. First, like other market makers, over-the-counter market makers generally are willing to make firm quotations for immediate acceptance only.[113] An over-the-counter market maker would be at a competitive disadvantage if he was required to hold his quotation firm while the exchange member takes his "order" to the floor.[114] In addition, it appears that the loss of advertising value of a third market tape print,[115] the risk of having a substantial trade "broken" by other bids and offers on the exchange floor (as a consequence of exchange priority and precedence rules),[116] and the difficulties which the over-the-counter market maker would experience as a consequence of having to disclose his acquisition price when he is a buyer (due to net printing of his transaction)[117] are disincentives to over-the-counter market makers' agreeing, as a general matter, to transact business on an exchange in the suggested manner.

Consequently, the Commission has concluded that neither access by dual ex-

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change member brokers to some over-the-counter market makers on some regional exchanges nor the ability of an over-the-counter market maker to give an "order" to an exchange member to be crossed on an exchange floor (without a commission charge to the market maker) provides an adequate substitute for direct access to over-the-counter market makers by all exchange member brokers.[118] Thus, the Commission is unable to conclude that any available alternative to such direct access comports with the statutory goals of achieving "economically efficient execution of securities transactions," "fair competition among brokers * * * and between exchange markets and markets other than exchange markets," or "the practicability of brokers executing investors' orders in the best market." [119]

Except for the arguments presented above, it has not generally been disputed that exchange off-board trading rules governing agency transactions impose substantial burdens on competition. Since the Commission has concluded that such rules do impose substantial burdens on competition, it must determine whether, nevertheless, those rules can be justified as necessary or appropriate in furtherance of the purposes of the Act in light of the statutory goals discussed above.

Witnesses at the October Hearings and commentators favoring retention of some form of requirement that an exchange floor be checked physically and that one or more categories of orders represented there be satisfied prior to any third market execution of an agency order argued that failure to retain some such requirement would induce members of exchanges to abandon their memberships, would result in a significant loss of orders from exchanges to the third market, would result in the bypassing of public orders entitled to priority, would reduce the quality of market making by specialists (particularly in less active stocks), would lead to undue concentration in the securities industry, would destroy the auction process (leading to dealer markets), would destroy investor confidence in the fairness of the markets, and (because of the combination of the foregoing factors) would make the capital raising process generally more difficult.[120]

Opposing views were that any modification of those rules which continued the existing requirement that an exchange floor be checked prior to an over-the-counter trade would not result in any change in the handling of most orders presently directed to exchange floors, and that even abrogation of those rules would lead only to relatively minor shifts in order flow from exchange markets to the third market (and then only because of better prices and greater efficiencies offered by that market).[121] Indeed, it would appear that, since most large retail member firms transmit their orders automatically to the "primary" exchange market by means of automated routing systems (because individual handling of a large volume of orders is inefficient and because checking alternative markets, under existing circumstances, is a costly and sometimes risky way of doing business even where it is possible to do so), all orders handled by such firms (except sizable orders, where the amount of commission involved justifies different treatment) will continue, at least for the immediate future, to be directed automatically to the "primary" exchange regardless of any change in exchange off-board trading rules relating to agency transactions.[122]

See footnotes at end of document.

As indicated earlier in the discussion of off-board trading rules governing principal transactions, reallocation of the order flow presently enjoyed by existing exchange markets and the over-the-counter market could occur today in a number of ways for numerous reasons unrelated to the continued existence or disappearance of off-board trading rules.[123] It has never been a function of the Commission (or among the purposes of the Act) to take, or refrain from taking, regulatory action solely to preserve any market center's existing order flow.[124] While the Commission has determined, for the present, to leave in place exchange restrictions on off-board principal transactions (principally because of certain potential problems associated with the initiation of over-the-counter market making by members of exchanges),[125] similar considerations do not apply to retention of exchange restrictions on off-board agency transactions. In any event, the Commission is not now prepared to conclude that a major reallocation of order flow among existing markets (i.e., a sudden and pronounced exodus of orders from the exchanges to the over-the-counter market) will necessarily occur.

The "primary" exchange markets presently command an overwhelming percentage of all orders in multiply-traded securities.[126] Those markets generally offer more opportunities to achieve executions (particularly for orders of relatively modest size and for limited price orders) than are available in all alternative markets combined; even a material reduction in the number of orders currently centralized on those exchanges would not alter this fact.[127] It presently appears that those markets will continue to offer an environment in which there is the greatest likelihood that orders of modest size will receive prompt executions satisfactory to customers, particularly if they continue to offer the benefits that have made them attractive to brokers and dealers in the past.[128] Thus, for example, where speed of execution is essential in a transaction (e.g., a market order, where "missing the market" is a significant risk), there is a substantial natural incentive to transmit that order directly to the "primary" market, absent knowledge that a price at least as favorable as that which could have been obtained in that market can be secured in another market.[129] This judgment is supported by the reliance presently placed by major retail firms on automatic order routing equipment to transmit orders to the "primary" exchanges for execution.[130] Thus, it would appear unlikely that the "primary" exchanges will suffer any substantial loss of order flow merely because exchange rules preventing customers' orders from being executed in the third market are eliminated. Where exchange members can be certain that superior executions can be achieved in the third market (or on exchanges other than the "primary" market), however, the Commission believes that such members, acting as brokers, must not be prevented from pursuing those opportunities for their customers.[131]

One aspect of the total abrogation of agency restrictions which is of some concern, however, is that new opportunities would be created for the in-house crossing of agency orders, where the executing firm would act as agent for both sides of the transaction. It has been asserted that these opportunities would prove irresistable to many firms, and that initiation of in-house crossing on a widespread basis would lead to a substantial dilution of the order flow currently shared by existing market centers, resulting in all of the adverse effects of market fragmentation discussed earlier, as a consequence of market making by exchange member firms under existing circumstances in the event off-board trading rules proscribing off-board principal transactions were eliminated.

With respect to relatively small retail orders, however, the Commission is not convinced, at the present time, that this development would occur since there appears to be little possibility that in-house crossing of such agency orders would offer cost savings of sufficient moment to offset the difficulties and legal risks inherent in "bunching" or "queuing" market orders (which, together with limited price orders, comprise the bulk of relatively small retail orders) to await arrival of another order as the opposite side of a transaction for purposes of matching or pairing in an execution. This would appear to be especially true in light of the fact that, unlike over-the-counter round-lot market making, internalization of the order flow represented by a firm's small retail orders would not generate profits from a "jobber's turn," and would offer cost savings (if any) only by eliminating expenses associated with transmitting agency orders to a market for execution, expenses which automated routing systems apparently have reduced significantly. In addition, the reprogramming of existing order handling systems (e.g., automated routing systems) to accommodate such a practice would appear to be both complex and expensive.

If, however, such a development were to occur under circumstances affording customers execution prices at least as favorable as those which the executing firm, in accordance with its agency responsibilities, knew or should have known could have been obtained in another market,[132] it may be desirable to permit such a development; transactions completed in-house still would be reported and publicized in the consolidated transaction reporting system (thus exerting an appropriate influence on price levels in all markets, including the prices bid and asked by market makers) and customers would be protected against over-reaching and various forms of customer favoritism by traditional agency and fiduciary principles. Finally, should this development occur (a prospect the Commission considers unlikely for the reasons set forth above), the Commission is armed with substantial powers under the Act to ensure that customers are protected from potential abuses should supplementary protections appear appropriate.[133]

It must be recognized that internalization of order flow could be achieved to some degree today, in the sense of pairing or matching orders for execution, if that practice would yield cost savings other than those attributable to transmitting orders to an exchange floor. Existing rules would not prevent a firm from matching orders as crosses and then bringing them to an exchange floor for execution. Finally, benefits to investors must not be overlooked. Such agency crosses would be executed under best execution principles between existing bid and asked thus affording smaller customers a better price than that obtainable in any market place.

With respect to substantial orders of block size, it does not appear that in-house crossing would result in new risks to customers, nor would there be significant new opportunities for avoidance of public orders represented on exchanges which are entitled to protection, or to any other undesirable effect which is prevented today by exchange restrictions on off-board agency transactions. First, customers engaged in such trades are among the most sophisticated of investors (i.e., such customers usually are institutions), and the prices at which such transactions occur generally are the result of intense bargaining. Second, in cases where avoidance of buying or selling interest represented on the floor of any particular exchange (e.g., the NYSE), interest which would be entitled to displace any portion of the block order if it were brought to the floor for execution, is important to completion of a block transaction, such interest can be avoided today by transporting the transaction to a regional exchange for execution.[134]

On the other hand, while there may be some cost savings associated with the ability of a member to avoid an exchange floor in effecting cross transactions, the Commission is not convinced that the expenses involved have significant anti-competitive effects. Members, of course, are permitted to internalize the execution function by establishing their own floor representation; moreover, after May 1, 1976, any member firm without its own floor brokerage capacity will be able to freely negotiate the charges it pays for this service. Additionally, if members were permitted to effect cross transactions in-house those members desiring to do so would be required to bear the expense of reporting such transactions for inclusion in the composite transactions reporting system. Widespread crossing of blocks upstairs by members might also contribute to the inefficiency of the existing pricing mechanism on the primary exchange floor.

While the same arguments presented above could be and have been made in an effort to justify restrictions on transactions by members with third market makers, there the substantial anti-competitive effects of such restrictions are sufficient to outweigh the benefits to centralization of order flow which such rules, in certain ways, represent. Similarly, the substantial fragmentation which could result from elimination of proprietary trading restrictions was an important consideration weighing in favor of retention of such restrictions at this time, even though it was recognized that eliminating the proprietary restrictions would likely enhance market making competition and the capital commitment necessary to absorb large institutional imbalances.

It follows therefore, that if restrictions on in-house cross transactions are not perceived to be anti-competitive in significant ways, the likelihood of fragmentation and the possibly detrimental effects flowing therefrom would be compelling arguments for retaining those restrictions.

Accordingly, during the interim period between adoption of Rule 19c-1 and January 2, 1977, when all restrictions or a member's ability to effect a customer's transaction over-the-counter with a third market maker or nonmember block positioner must be eliminated, the Commission intends to give further consideration to the issue whether over-the-counter cross transactions in listed securities by members should continue to be restricted, or not. In this regard, the Commission is requesting the National Market Advisory Board to advise the Commission of its views on this aspect of the off-board trading issue no later than October 1, 1976. Interested persons are requested to provide their views on this issue to the National Market Advisory Board and to the Commission no later than June 1, 1976.

It has also been argued that, while "primary" exchange markets may not experience a disruptive loss of order flow as a result of elimination of off-board trading rules governing agency transactions, regional exchanges would be certain to lose that portion of their order flow attributable to the activities of over-the-counter market makers which are members of those exchanges. If, indeed, this does occur it would appear inconsistent with the purposes of the Act for the Commission to attempt to prevent it.[135] But there may be significant reasons for over-the-counter market makers which are currently members of regional exchanges to retain their memberships (and continue their exchange activities) in the absence of exchange rules governing off-board execution of agency transactions. For example, such market makers' presence on the floors of regional exchanges enables members of those exchanges seeking executions for agency orders, as a practical matter, to check two markets at once (with all of the cost savings implied): the regional exchange's regular specialist and the over-the-counter market maker.[136]

Withdrawal of over-the-counter market makers from such exchanges would force members acting as brokers to choose between continuing to direct orders to the exchange and directing them to an over-the-counter market maker (or to incur the cost of two discrete inquiries), resulting, potentially, in a loss rather than a gain in business and exposure to order flow by over-the-counter market makers.

Other arguments with respect to a loss of order flow by regional exchanges in the event off-board trading rules governing agency transactions are eliminated are equally unpersuasive. For example, such action might precipitate a decline in the volume of large transactions transmitted to regional exchanges solely for the purpose of avoiding buying or selling interest on the floor of the "primary" exchange (because those orders could be effected in the over-the-counter market directly).[137] But, to the extent regional exchanges presently enjoy a volume derived from transactions between members of the "primary" exchange market and over-the-counter market makers which have joined regional exchanges as a consequence of avoidance of off-board trading rules, it cannot be argued that those rules should be retained in order to preserve a mechanism for their avoidance.

While it was asserted that elimination of off-board trading rules would lead to an exodus of exchange member firms, no reasons for this exodus other than regulatory disparities between the over-the-counter market and exchange markets and the profit potential of over-the-counter market making were suggested.[138] The Commission is committed to a regulatory environment in which all markets are subject to appropriately equal regulation, a goal of the Act, and to the equitable sharing of costs, on a comparable basis, by all participants in the markets.[139] As indicated above, the Commission has determined not to permit exchange members to engage in continuous market making in round lots over-the-counter at the present time, and would act swiftly to impose appropriate regulation on over-the-counter market making in multiply-traded exchage-listed securities by large retail firms should they abandon their memberships to initiate that activity.[140] The Commission has not been presented with any evidence, however, that the abrogation of restrictions on off-board agency transactions alone would lead any exchange member to abandon its exchange membership.

With respect to the argument that any modification or restrictions of off-board agency transactions (or elimination of

See footnotes at end of document.

those restrictions) might lead to a deterioration in the depth and liquidity of exchange markets and in the continuity of prices on those markets, at cross purposes with the goal of economically efficient executions, the Commission is not persuaded that these effects would result.[141] For example, it is argued that a loss of exchange order flow would result in a widening of specialists' spreads. As indicated above, the Commission expects increased competition in market making to have the opposite result as each market maker attempts to attract order flow.[142] In addition, it has been suggested that the quality of exchange markets made by specialists will suffer because specialists will no longer be able to depend upon the subsidy afforded by their privileged positions with respect to the most actively traded stocks and brokerage from limit orders.[143]

Neither argument is compelling. Even if a material percentage of orders were to leave the "primary" exchanges (due to successful competition by over-the-counter market makers in the most active stocks), a prospect the Commission considers unlikely, at least in the short-term, the Commission doubts that specialists will make less satisfactory markets, or that the markets, considered as a whole, will lose liquidity, depth or price continuity, for the reasons suggested. With respect to limit orders, the "primary" exchanges will continue to afford mechanisms which maximize opportunities for executions of those orders (until development of a composite book) even if volume diminishes. In any event, regional exchange limit orders, currently dependent upon "primary market protection," should not be similarly affected.[144] Over-the-counter market makers do not, for the most part, offer limit order capacity. Accordingly, the Commission believes that elimination of off-board agency restrictions is more likely to contribute affirmatively to the so-called "internal efficiency" of the securities markets than not.

With respect to the argument that the quality of specialist market making in inactive securities is dependent on profits from market making in active securities (which will be diminished by increased competition in those securities), the Commission has not been able to ascertain that this cross-subsidy actually exists. Commentators have not identified any facts which would prove the existence or the extent of any cross-subsidization. Furthermore, competition from over-the-counter market makers is not qualitatively different in this context from increased competition from regional exchange specialists. Finally, the Commission is of the view that increased competition for order flow would comport with the statutory mandate to provide "fair competition" among brokers and dealers, among exchange markets and between exchange markets and markets other than exchange markets, while attempts to insulate the income of primary exchange specialists to support their market making in inactive securities would not.[145]

Of all the arguments advanced in favor of retaining some form of off-board trading rule requiring that an exchange be interrogated, and that at least certain orders on that exchange be satisfied by a member wishing to effect a third market agency transaction, the most persuasive concerned the desirability of continuing protections for public limit orders, to provide a means for those orders to participate in transactions which otherwise would occur at prices below those which the public is willing to pay or above those at which the public is willing to sell.[146]

As explained below, the Commission believes that it is essential to create a central mechanism for the national protection of limited price orders.[147] Testimony presented at the October Hearings cogently argued that such protection is fundamental to the fairness of our securities markets.[148] Existing exchange mechanisms designed to protect limit orders and provide for their participation in transactions occurring on particular exchanges, however, are inadequate for the future and can be circumvented under existing circumstances by members of "primary" exchanges (who may transport an order to a regional exchange if avoiding the limit order book on the "primary" exchange is an important factor in consummating a substantial trade) and by customers (who are not required to effect a transaction on an exchange at all).

Thus, it appears that no Commission action with respect to off-board trading restrictions on agency trades would have any material impact on such integrity as existing limit order systems may have, at least in the immediate future. In any event, testimony was presented at the October Hearings to the effect that exchange members generally clear limit orders on the specialist's book prior to executing a transaction on a regional exchange even though they are under no legal compulsion to do so.[149]

To the extent that exchange members find it desirable to clear the limit order book prior to executing a transaction on a regional exchange, it would appear that they would also do so prior to executing orders in the third market. Furthermore, the statutory goal of improving the ability of exchange members to execute customers orders in the best market would be frustrated by any Commission action which would circumscribe a broker's ability to seek competitive bids and offers expeditiously.

Brokers entrusted with an agency order should and will be able to execute that order in any market and in any manner which presents the most advantageous opportunity for an execution.[150] The Commission can perceive little reason why satisfaction of public limit orders should be mandated when an exchange member wishes to effect a transaction directly with an over-the-counter market maker, but not mandated when the same member effects the same transaction with the same over-the-counter market maker on a regional exchange. Moreover, even if public limit orders on the "primary" exchange were required to be filled prior to a transaction by a dual member on a regional exchange (a proposition which the regional exchanges have termed "disastrous" to their markets), opportunities for avoidance would still exist. For example, transactions effected by sole members of regional exchanges, third market brokers and over-the-counter market makers and fourth market transactions would not be subjected to displacement by limit orders entered in the "primary" market. It is clear, therefore, that the only fair, realistic and practicable way of mandating satisfaction of public limit orders, a goal the Commission shares with all those witnesses who have stressed the importance of public limit order precedence, is through the creation and development of a composite book and the imposition of a requirement that all transactions, wherever and by whomever effected, must clear that book.

Some witnesses stressed in the October Hearings that the advantages which institutional investors have over individual investors, in securing opportunities for favorable investment positions, are increasing in a manner incompatible with the maintenance of public confidence in the fairness of the markets.[151] It was the conclusion of these witnesses that exchange mechanisms for protecting public limit orders (which generally represent individual rather than institutional interest) must be preserved by retention of off-board trading rules in order to shore up the confidence of retail investors in the fairness of the trading markets.[152] The Commission believes this argument is ill-founded.

Institutional investors today have every opportunity to effect orders directly with third market makers whenever they believe it is advantageous to do so. Moreover, brokerage firms are willing to explore all of the varied opportunities for execution of an order in size which presently exist because the compensation involved in effecting a sizable order would justify any additional expense. NYSE member firms, however, which represent the great majority of retail orders in listed securities, are not similarly permitted to utilize whatever added liquidity and superior execution opportunities the third market may represent to benefit their retail customers. Any requirement that, prior to a third market execution with an over-the-counter market maker, a member must first physically explore the market on the floor of an exchange would make the use of the third market for round-lot orders uneconomical.

It would be anomalous, at best, for the Commission to question the right of an exchange member diligently to explore and use any and all competing markets and methods of achieving executions when individual customers would benefit financially thereby. Exchange restrictions which have the effect of preventing

See footnotes at end of document.

a member from offering professional coverage of competing markets for retail customers, similar to that coverage which members provided to institutional customers, cannot therefore be permitted to continue.[153]

It would appear that exchange members would have little use for a composite quotation montage reflecting round-lot bids and offers by competing market makers if exchange rules effectively foreclosed access to certain of those market makers. On the other hand, the relaxation of off-board restrictions on agency transactions and the ultimate elimination of such restrictions, could enhance the utility of a composite quotation montage and provide a useful tool to exchange members in serving their customers. While the Commission does not believe it likely that a majority of firms (at least in the near term) would attempt to make decisions as to the best market with respect to each small order even if a composite quotation system were available, nevertheless, should a member decide to provide such service for retail customers, that event should be welcomed, not prevented.

As a consequence of its conclusions regarding the anticompetitive impacts of exchange off-board trading rules governing agency transactions, and in light of the Commission's inability to conclude, based upon its experience to date, the retention of those rules can be justified by reference to the purposes of the Act, the Commission has determined to adopt Rule 19c-1 under the Act, eliminating all such rules as of January 2, 1977, after which, pursuant to that Rule, no rule of any national securities exchange shall be construed to impose, directly or indirectly, any requirements, limitations or restrictions on members of those exchanges with respect to the execution of agency orders over-the-counter.

The Commission is providing a one year period prior to eliminating exchange restrictions on over-the-counter agency transactions in the interests of providing time to the exchange community, members of exchanges and the securities industry at large to consider such adjustments in current ways of doing business and in the existing pattern of regulation as may be deemed appropriate in response to the rule. In addition, the Commission wishes to afford the securities industry and self-regulatory organizations an opportunity to exert their best efforts to achieve the prompt implementation of a composite book, discussed below, to provide nationwide protection to limited price orders of public customers. In the interim, to facilitate the transition to complete abrogation of exchange off-board trading rules governing agency transactions, the rule provides that, after March 31, 1976 and until January 2, 1977, an exchange may, by rule, afford protection to limited price orders entered on an exchange specialists' book in the manner specified in the rule.[154] During this period, the Commission intends to evaluate the consequences flowing from relaxation of off-board agency restrictions prior to complete abrogation of exchange off-board trading rules governing agency transactions to determine what, if any, additional regulatory measures might be necessary or appropriate in light of experience during the interim period.

See footnotes at end of document.

IV. DEVELOPMENT OF COMPOSITE BOOK

The instant proceedings, and the entire question of off-board trading rules, must be viewed not only with respect to the merits of individual exchange trading rules, but also in the context of the development and implementation of a national market system. In this regard, the Commission was encouraged that, despite differing views as to whether off-board trading restrictions should be abrogated or modified at this time, all commentators appeared to support the fundamental concept and goals of the national market system envisaged by Congress in enacting the Securities Acts Amendments of 1975.[155] Indeed, certain commentators submitted for the record detailed and specific models designed to implement a national, centralized trading system having the characteristics necessary to achieve the regulatory objectives and goals of Section 11A.[156] The Commission found these proposals to be helpful and constructive for purposes of the present proceeding and future planning.

Nevertheless, the Commission does not believe that its Congressional mandate to facilitate the development of a national market system in accordance with the findings and objectives enunciated by Congress should be construed to demand inaction at this time with respect to off-board trading restrictions; in fact, if anything, the opposite is the case. Historically, the Commission has viewed the integration of third market firms into the existing market structure as a fundamental and important step toward true centralization of order flow under fair conditions. Thus, in its February 2, 1972 "Statement on the Future Structure of the Securities Markets," the Commission concluded that four major steps were required.

(1) Implementation of a nationwide system for disclosure of market information designed to make price and volume information in all markets and quotations from all market makers universally available;

(2) Elimination of artificial impediments, created by exchange rules or otherwise, dealing in the best available market;

(3) Establishment of terms and conditions upon which any qualified broker-dealer can negotiate access to all exchanges; and

(4) Integration of third market firms into the central market system and making them subject to appropriate market responsibilities and other regulatory requirements commensurate with the benefits they may realize.[157]

Several important initiatives have already been taken to further these goals. The Commission's short sale rules have been amended to extend their application to "third market" transactions.[158] A uniform net capital rule, applicable to a broad segment of the securities industry, has been adopted,[159] and comprehensive anti-manipulative rules for all market centers are in place.[160] The exchanges and the NASD are now in the final stages of implementing a consolidated transaction reporting system in accordance with a joint industry plan filed with and declared effective by the Commission pursuant to Rule 17a-15 under the Exchange Act.[161] This system, which is already operational with respect to NYSE-listed securities, will enable investors to make more informed judgments regarding which market centers offer the most advantageous price at a particular time. In the area of quotation information, all exchange restrictions on the dissemination of such information have been eliminated.[162] In addition, the adoption of Rule 19b-3,[163] abolishing fixed rates of commission for transactions on exchanges, has permitted brokers to negotiate the cost of access to the various exchanges.[164] The Commission believes that the adoption of Rule 19c-1 [165] is an important step in integrating existing markets.

Nevertheless, the Commission agrees with the thesis of many commentators that maximization of the opportunities for bids and offers to meet and for comprehensive protection for limit orders can only be fully achieved through a true national market system, and that those objectives are worth pursuing. For this reason, the Commission is also announcing today the steps it intends to take in the immediate future to provide the kind of comprehensive limit order protection which all commentators apparently agree is in the public interest.

The Commission believes that public limit orders and the intended function of the specialist's limit order book have important roles in our securities markets, and that displacement of proposed transactions between securities customers (or their brokers) and market makers by such orders, under certain circumstances, is appropriate in the public interest and for the protection of investors to ensure the fairness of the markets and an opportunity for public orders to meet without the participation of a dealer.[166] Existing exchange mechanisms for the storage and execution of limited price orders, however, by their very nature are unable to provide full protection for those orders, and the regulatory devices employed to ensure execution of such orders engender certain adverse effects which, as noted elsewhere in this release, outweigh their laudable objectives.

First, as discussed above, limit orders may be avoided, in whole or in part, by a number of techniques, including the execution of a transaction on a regional stock exchange. Second, dual members are not required to satify orders on the books of all the exchanges for which they are members before they execute a trade on any particular exchange, and existing technology would make such a requirement, if imposed, wholly impracticable. Finally, existing exchange rules regarding priority and precedence and renewal of the "auction" after each transaction do not, in our view, provide an ideal framework for the protection of public orders (especially those of small size).[167]

The Commission believes that the answer to the problem of providing adequate protection for public limit orders is not to maintain existing rules which perforce provide only imperfect protection and have certain undesirable anticompetitive effects, but rather to use the advanced technology now available to provide for a computerized central limit order repository, or composite book.[168] A composite book would permit the effective integration of existing market makers (both exchange and third market by ensuring continuation and extension of the public's ability to obtain priority in competing for executions; in addition, such a book would provide brokers and dealers with an efficient and practical means by which all limit orders, regardless of origin, can be protected on a national basis.[169] Once a composite book is in place, the Commission believes that all transactions, regardless of size, should be required to satisfy orders on that book at the same or at a better price either immediately before, simultaneously with or immediately after execution.

The Commission believes that substantial progress can be made in developing a composite book prior to the date established today for elimination of agency restrictions on off-board trading. In that regard, and in conjunction with our action with respect to off-board trading rules, the Commission proposes to implement the following steps to achieve a composite book as rapidly as possible. First, the Commission plans to propose, pursuant to its authority under the Act (and particularly sections 2, 3, 6, 10, 11, 11A, 15, 15A, 17, and 23 thereof), a rule which will request self-regulatory organizations and securities information processors (separately or together with one or more self-regulatory organizations) to submit plans for the design, construction and operation of a composite book meeting certain minimum specified characteristics. The Commission has not made any final determination as to the characteristics which each such plan should include. For purposes of securing meaningful discussion the following is a list of proposed characteristics of a composite book:

(1) The composite book system must be capable of storing all limited price orders entered through either an exchange specialist or a qualified third market maker;[170]

(2) Entry points for orders to be inserted in the composite book initially would be through existing specialists and qualified third market dealers (who must also have the ability to cancel orders once entered);

(3) The composite book must be capable of storing and queuing orders in such a way that all public agency orders (i.e., agency orders for persons other than brokers or dealers) at particular prices would have priority over all orders at those prices entered for the accounts of brokers or dealers;

(4) Priority on the book, at least initially, would be based first on price and then on time of entry; no order entered in the composite book system would receive precedence based on size;

(5) All limited price orders entered in the composite book (indicating price and size) must be capable of retrieval for display purposes by any broker or dealer without disclosing the identity of the broker or customer for whom the order was entered or of the specialist or market maker who entered the order;

(6) Specialists and market makers must have the ability to achieve executions against orders contained in the composite book (by electronic entry) in the order of priority determined in accordance with paragraphs (3) and (4);

(7) Immediately after execution against orders contained in the composite book, the system must have the capability of notifying (i) both the specialist or market maker who entered an order and the specialist or market maker who executed against that order that an execution has been achieved (identifying the particular order and the specialist or market maker); or (ii) the specialist or market maker attempting the execution that no execution was achieved;

(8) The composite book system must have real time update capacity for information based on entry, cancellation or execution of an order; and

(9) All limited price orders will be permitted to be entered in the composite book and all proposed transactions will be required to clear the composite book contemporaneous with execution.

The above list of characteristics is not intended to be exhaustive, and may be supplemented prior to the solicitation of plans. Moreover, persons submitting plans will be requested to specify the extent to which existing types of hardware can be adapted for use with the composite book system in order to reduce development costs and to provide a method for periodic evaluation of any processor selected (and for replacement of the processor, if necessary) under specified terms and conditions.

The Commission intends to solicit comments on the characteristics enumerated above (from a regulatory, efficiency and cost standpoint), the specifications of any plan for the implementation of a composite book, the appropriate manner of selecting among plans and alternative means for achieving an operational composite book speedily. Prior to the Commission's solicitation of such comments, however (which the Commission anticipates will be announced on or about February 15, 1976), the Commission intends to consult with the National Market Advisory Board so that the Commission's request for comments and other information will reflect the careful consideration of the Board.

Similarly, once plans have been submitted, it is the Commission's intention to evaluate the plans in concert with the National Market Advisory Board and in the light of public comment, and select and approve a basis for the development of the composite book.[171] Any developer would be expected to construct and operate the book in accordance with the plan, subject to Commission oversight, and to incur whatever development costs are required (recovering those costs from charges imposed upon users of the composite book system, once operational). In evaluating or selecting any plan for implementation of the composite book, the Commission will consider those factors which it deems necessary for the public interest, the protection of investors, and the elimination of impediments to the development of a national market system. These factors will include but not be limited to, the following: (1) cost of development and operation, (2) allocation of costs and charges, (3) level of charges for use of the system, (4) capacity of the system, (5) provision for maximum use of existing hardware, (6) provision for (including cost of) compatibility with potential competing systems, (7) time for completion, (8) ease of operation and maintenance, (9) response time, (10) availability and reliability of back-up systems, (11) provisions for integrity of the system, (12) ability to modify or enhance the system, and (13) extent to which the system is (or may be made) readily accessible to all qualified parties (including market professionals other than specialists and market makers).

Although the national securities exchanges and the NASD will be permitted to submit plans in conjunction with a securities information processor, and plan submitted by, or on behalf of, a self-regulatory organization, must provide a means of ensuring that the development and operation of the composite book system will not be dominated or controlled by any market center.[172]

Concurrently with the Commission's announcement of the solicitation of comments adverted to herein, the Commission also intends to announce a proposed timetable for implementation of the consolidated book. In the Commission's view, adherence to a timetable designed to spur the speedy development of an operational composite book is a matter of considerable importance. The failure to make meaningful progress toward a composite book would cast doubt on the viability of a national market system. If the legislative objective of establishing a national market system is not achievable within a reasonable period of time, the Commission will seek further to enhance competition as a method of fulfilling the objectives of the Act.

V. FURTHER STUDY

The Commission has reached the conclusions set forth herein on the basis of a review of the provisions of the Act (particularly the 1975 Amendments), oral and written comments, data and other information most recently made available

See footnotes at end of document.

in the course of the hearing on the proposed alternative and information which previously became available to it in the course of its ongoing regulatory activities.

In adopting Rule 19c-1, the Commission has not foreclosed the possibility that further changes may be necessary or appropriate after experience with the rule is gained and analyzed. The Commission will carefully evaluate the implementation, operation and impact of Rule 19c-1 in order to assure that the statutory objectives of the Act are fulfilled.

The Commission has established a timetable for the gradual implementation of changes in off-board trading restrictions in order to allow broker-dealers and their customers an opportunity to adapt to and plan for such changes. The Commission further believes that the timetable adopted will allow sufficient opportunity for the newly established National Market Advisory Board to formulate and furnish its views to the Commission as it is mandated to do by statute. The Commission expects the Board to work closely with self-regulatory bodies and other segments of the industry to determine the steps it finds appropriate to facilitate the establishment of a national market system and to report to the Commission any progress toward that objective prior to the scheduled elimination of all restrictions on agency transactions. The Commission will seek information requested by the Board from the securities industry and intends to provide other support to facilitate the Board's efforts.

VI. ADOPTION OF RULE 19C-1

The Securities and Exchange Commission hereby adopts Rule 19c-1 (17 CFR 240.19c-1), effective March 31, 1976, pursuant to its authority under the Securities Exchange Act of 1934, and particularly sections 2, 3, 6, 11, 11A, 17, 19 and 23 thereof.[173] The Commission finds that adoption of Rule 19c-1 is necessary or appropriate in furtherance of the purposes of the Act, and in order to conform the rules of national securities exchanges to the requirements of the Act. The Commission further finds, for the reasons expressed in this release, that Rule 19c-1 does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

Rule 19c-1 provides that, on and after March 31, 1976, the rules of each national securities exchange shall provide that no rule, stated policy or practice of that exchange shall prohibit or condition, or be construed to prohibit, condition or otherwise limit, directly or indirectly, the ability of any member acting as agent to effect transactions on any other exchange or over-the-counter with a third market maker or nonmember block positioner in any equity security which is listed on that exchange or to which unlisted trading privileges on that exchange have been extended ("exchange securities").

The rule also provides that, notwithstanding the above prohibition, national securities exchanges may (but are not required to) maintain certain limited restriction on off-board agency transactions until January 2, 1977. Thus, Rule 19c-1 permits national securities exchanges to adopt, and maintain in effect until January 2, 1977, rules which assure that, either immediately before, simultaneously with or immediately after execution of a transaction in any exchange security over-the-counter with a third market maker or nonmember block positioner, public bids or offers entered on the specialist's book, or any other limit order mechanism, as limited price orders at prices equal to or better than the transaction price are satisfied.

The rule does not specify the manner in which limit orders on the specialist's book must be satisfied, and thus permits satisfaction on such orders either by the specialist in the security (acting as dealer) or by the broker effecting the off-board transaction (acting as agent).[174] An exchange may require that satisfaction of limit orders must be achieved in a particular manner. However, in the case of regional exchanges, the Commission anticipates, in accordance with their traditional practice of affording primary market protections that until a consolidated book is operational such exchanges will require that limit orders on the book be filled by the specialist in that security.

In addition to permitting exchanges to specify the manner in which limit orders on the specialist's book are to be satisfied in connection with an off-board agency transaction, Rule 19c-1 also permits an exchange to require that such limit orders be satisfied at the transaction price rather than the limit price. This optional "gapping" provision is provided to permit exchanges to vary their treatment of public limit orders under circumstances consistent with the purposes of Rule 19c-1, the public interest and the protection of investors.

In view of our determination to adopt Rule 19c-1 the Commission hereby withdraws proposed Rules 19c-1[A], 19c-1 [B] and 19c-1[C]. With respect to the Market Responsibility Rule filed by the NYSE during the course of the proceeding to replace NYSE Rule 394, the Commission, by separate order, has disapproved that rule in accordance with section 19(b)(2) of the Act.

17 CFR Part 240 is amended by adding a new § 240.19c-1, effective March 31, 1976, to read as follows:

§ 240.19c-1 Governing Off-Board Trading by Members of National Securities Exchanges.

The rules of each national securities exchange shall provide, after March 30, 1976, as follows:

(a) Except as hereinafter provided by this rule, no rule, stated policy or practice of this exchange shall prohibit or condition, or be construed to prohibit, condition or otherwise limit, directly or indirectly, the ability of any member acting as agent to effect transactions on any other exchange or over-the-counter with a third market maker or nonmember block positioner in any equity security which is listed on the exchange or to which unlisted trading privileges on the exchange have been extended ("exchange securities").

(b) Beginning March 31, 1976, and ending January 2, 1977, the provisions of paragraph (a) of this section shall not apply to a rule of this exchange approved by the Securities and Exchange Commission pursuant to section 19(b)(2) of the Act which assures that, either immediately before, simultaneously with or immediately after execution of a transaction in any exchange security over-the-counter with a third market maker or nonmember block positioner, public bids or offers entered on the specialist's book, or on any other limit order mechanism on such exchange, as limited price orders at prices equal to or better than the transaction price ("limit orders") are satisfied at the limit prices bid or offered: *Provided, however*, That such limit orders may be required to be satisfied at the transaction price under circumstances consistent with the purposes of this rule, the public interest and the protection of investors.

(c) For purposes of this rule:

(1) The term "third market maker" shall mean a "market maker" as defined in Rule 15c3-1(c)(8) (§ 240.15c3-1(c)(8)) under the Act, who makes markets over-the-counter in exchange securities and who maintains the minimum net capital required of a market maker by Rule 15c3-1 (§ 240.15c3-1) under the Act.

(2) The term "nonmember block positioner" shall mean a "block positioner" as defined in Rule 17a-17 (§ 240.17a-17) under the Act which is not a member of this exchange.

(Secs. 2, 3, 6, 11, 17, 19, 23, Pub. L. 73-291, 48 Stat. 881, 882, 885, 891, 897, 901 (15 U.S.C. 78b, 78c, 78f, 78k, 78g, 78s, 78w); Sec. 7, Pub. L. 94-29, 89 Stat. 111 (15 U.S.C. 78k-1))

Effective date. This amendment to Part 240 becomes effective on March 31, 1976.

By the Commission.

[SEAL] GEORGE A. FITZSIMMONS,
Secretary.

DECEMBER 19, 1975.

FOOTNOTES

[1] Pub. L. 73-291, 48 Stat. 881 (15 U.S.C. 78) ("Act"), and particularly Secs. 2, 3, 6, 11, 17, 19, 23, Pub. L. 73-291, 48 Stat. 881, 882, 885, 891, 897, 901 (15 U.S.C. 78b, 78c, 78f, 78k, 78q, 78s, 78w) thereof; Sec. 7, Pub. L. 94-29, 89 Stat. 111 (15 U.S.C. 78k-1).

[2] SEC, "Report of the Securities and Exchange Commission on Rules of National Securities Exchange Which Limit or Condition the Ability of Members to Effect Transactions Otherwise than on Such Exchanges" (September 2, 1975) ("September Report").

[3] Securities Exchange Act Release No. 11628 at 3, 42 (September 2, 1975). ("Release No. 11628").

[4] Section 11A(c)(4)(A) of the Act.

[5] Pub. L. 94-29, 89 Stat. 97 (amending 15 U.S.C. 78).

[6] Committee of Conference, Conference Report to Accompany S. 249, H. Rep. No. 94-229, 94th Cong., 1st Sess. 95 (1975) ("Conference Report").

[7] Section 19(c) of the Act.

[8] Release No. 11628, supra note 3, at 3.

See footnotes at end of document.

[9] *Id.* at 46–50.

[10] *Id.* at 3.

[11] *Id.* at 58. In response to that request, the Commission received over 335 pages of written comments from 160 individuals associated with the securities industry, academic institutions, government agencies, and the public, and several hundred letters of comment from executives of listed companies. In addition, in response to an earlier request for comment, the Commission received 310 pages of written analysis from over 161 commentators. See Securities Exchange Act Release No. 11521 (July 2, 1975).

[12] "In the Matter of Rules of National Securities Exchanges Which Limit or Condition the Ability of Members to Effect Transactions Otherwise than on Such Exchanges," Commission File No. 4–180 (1975) ("Proceeding Transcript"). During the course of the hearings, the Commission received testimony from 63 individuals representing the following 19 institutions and organizations: Association for the Preservation of the Auction Market ("APAM"), Source Securities Corporation ("Source Securities"), Stockholders of America, Inc. ("SOA"), Pacific Stock Exchange, Inc. ("PSE"), Merrill Lynch, Pierce, Fenner & Smith, Incorporated ("Merrill Lynch"), INA Corporation ("INA"), Weeden & Company, Incorporated ("Morgan Stanley"), National Association of Investment Clubs ("NAIC") Ad Hoc Committee of Regional Firms ("Ad Hoc Committee"), Boston Stock Exchange ("BSE"), U.S. Department of the Treasury ("Treasury"), Securities Industry Association ("SIA"), American Stock Exchange, Inc. ("MSE"), New York Stock Exchange, Inc. ("NYSE"), The City of New York ("NYC"), Oppenheimer & Co., Inc. ("Oppenheimer"), and Sherman, Dean & Co. ("Sherman Dean"). In excess of 1400 pages of testimony were recorded and the Commission received over two hundred pages of additional exhibits supplementing that testimony.

[13] See, e.g., "In the Matter of Commission Rate Structure of Registered National Securities Exchanges," Commission File No. 4–144 (1968–1971); "In the Matter of the Structure, Operation and Regulation of the Securities Markets," Commission File No. 4–147 (1971); "In the Matter of Commission Rate Schedules of Registered National Securities Exchanges," Commission File No. 4–167 (1973); "In the Matter of Intra-Member Commission Rate Schedules of Registered National Securities Exchanges," Commission File No. 4–171 (1974); "In the Matter of Brokerage Practices," Commission File No. 4–172 (1974); "In the Matter of Commission Rate Schedules of Registered National Securities Exchanges," Commission File No. 4–174 (1974).

[14] E.g., SEC, "Staff Report: Rule 394" (1965), reprinted in 6 "Study of the Securities Industry, Hearings Before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce," H.R. Serial No. 92–37e, 92d Cong., 2d Sess., pt. 6, at 3293–3372 (1972); SEC, "Institutional Investor Study Report," H.R. Doc. No. 92–64, 92d Cong., 1st Sess. (1971); "Statement of the SEC on the Future Structure of the Securities Markets," Securities Exchange Act Release No. 9484 (February 2, 1972) ("Future Structure Statement"); "Report to the SEC by the Advisory Committee on Market Disclosure on a Composite Transaction Reporting System" (July 17, 1972); "Report to the SEC by the Advisory Committee on Block Transactions" (August 7, 1972); "Interim Report of the Advisory Committee on a Central Market System to the SEC on Regulation Needed to Implement a Composite Transaction Reporting System" (October 11, 1972); "Report to the SEC by the Advisory Committee on a Central Market System" (March 6, 1973); SEC, "Policy Statement on the Structure of a Central Market System," Securities Exchange Act Release No. 10076 (March 29, 1973) ("Policy Statement"); "Preliminary Statement of the Advisory Committee on the Implementation of a Central Market System to the Securities and Exchange Act Release No. 11131 (December 11, 1974); Securities and Exchange Commission Advisory Committee on the Implementation of a Central Market System, "Summary Report" (July 17, 1975).

[15] Release No. 11628, supra note 3, at 4.

[16] 17 CFR 240.19b–1.

[17] Release No. 11628, supra note 3, at 5, 6. Amendments to Rule 394(b) were proposed by the NYSE on October 4, 1974, pursuant to 17 CFR 17a–8 under the Act. The proposed amendments were described in the September Report, supra note 2, at 6, 7 and in Appendix A at A–4–20. No action was taken on these amendments and the NYSE did not refile them pursuant to section 19(b) of the Act and 17 CFR 19b–4 thereunder.

[18] For a more extensive discussion of existing exchange off-board trading rules, see Appendices A and C of the September Report, supra note 2, and Release No. 11628, supra note 3, at 4–14.

[19] Five regional exchanges permit over-the-counter market makers to become members and act as alternate specialists while continuing their over-the-counter market making activities. See Appendix C of the September Report, supra note 2, at C–20–29. Example of categories of exempted transactions are: transactions in certain guaranteed and preferred securities, exchange approved specialist purchases and sales, foreign transactions, sales of restricted securities (i.e., those whose transferability is limited by the Securities Act of 1933), charitable trades, trades to correct errors, transactions in securities in which trading on the exchange has been suspended, purchases prior to special unregistered offerings and exchange distributions, and unregistered secondary distribution sales.

[20] Brokers and dealers which are not members of any exchange may effect transactions as principal or agent freely in any market (including the third market) since they are not subject to exchange off-board trading rules. When executing a transaction on an exchange, of course, such a broker or dealer must negotiate access to that market in terms of any commission required by a member of that exchange as a fee for effecting an exchange execution; nonmember brokers and dealers may not effect transactions directly on an exchange without employing the services of an exchange member.

[21] See September Report, supra note 2, at 23, 27.

[22] See text accompanying note 92, infra.

[23] See text accompanying notes 94–97, infra.

[24] Senate Committee on Banking, Housing and Urban Affairs, "Report to Accompany S. 249," S. Rep. No. 94–75, 94th Cong., 1st Sess. 13 (1975) ("S. 249 Report"). Accord, House Committee on Interstate and Foreign Commerce, "Report to Accompany H.R. 4111," H.R. Rep. No. 94–123, 94th Cong., 1st Sess. 49 (1975) ("H.R. 4111 Report").

[25] S. 249 Report, supra note 24, at 13. See, e.g., Sections 6(b)(8), 19(b), 19(c), 19(e), 19(f) and 23(a) of the Act.

[26] S. 249 Report, supra note 24, at 7.

[27] Id. at 8.

[28] Section 11A(a)(2) of the Act.

[29] Section 11A(a)(1) of the Act. Specifically, Congress determined that the securities markets are an important national asset to be preserved and strengthened; that new data processing and communications systems create the opportunity for more efficient and effective markets; that it is in the public interest to assure (i) economically efficient mechanisms for the execution of transactions; (ii) fair competition among brokers and dealers, among markets and between exchange markets and over-the-counter markets; (iii) the availability of information with respect to quotations for, and transactions in, securities; (iv) the practicability of brokers executing investors' orders in the best market; and (v) an opportunity for investor orders to be executed without the participation of a dealer, so long as such opportunity would be consistent with clauses (i) and (iv); and that the linking of all markets for qualified securities through communications and data processing facilities will foster efficiency, enhance competition, increase the information available to brokers, dealers and investors, facilitate the off-setting of customers' orders and contribute to the best execution of such orders.

[30] S. 249 Report, supra note 24, at 8–9. In this regard, the S. 249 Report stated: [A]t this state of market development and technological innovation the Committee believes it is best to allow maximum flexibility in working out specific details. For these reasons, the Committee determined it essential that the Commission be granted broad, discretionary powers to oversee the development of a national market system and to implement its specific components in accordance with the findings and to carry out the objectives set forth in the bill. Id. at 7.

[31] Id. at 8. Similarly, the H.R. 4111 Report stated: The bill does not attempt to give definition to a national market system. Nor is it either feasible or desirable /sic/ for the Commission or any other agency of the government to predetermine and require a particular structure. Instead, the Commission is directed to act to modify the structure as it evolves through the ingenuity and response of the marketplace to the extent that changes occur that are found inconsistent with the public interest. Nevertheless, this bill does define certain goals and principles to serve as a guide to the industry and to the Commission in this evolutionary process. These goals * * * embrace the principles of competition in which all buying and selling interests are able to participate and be represented. The objective is to enhance competition and to allow economic forces, interacting within a fair regulatory field, to arrive at appropriate variations of practices and services. Neither the markets themselves nor the broker-dealer participant /sic/ in these markets should be forced into a single mold. Market centers should compete and evolve according to their own natural genius and all actions to compel uniformity must be measured and justified as necessary to accomplish the salient purposes of the Securities Exchange Act, assure the maintenance of fair and orderly markets and to provide price protection for the orders of investors. H.R. 4111 Report, supra note 24, at 50–51.

[32] Section 11A(d)(1) of the Act. The National Market Advisory Board was established on September 30, 1975.

[33] Section 11A(d)(3)(A) of the Act.

[34] Section 11A(d)(2) of the Act.

[35] Sections 6(b)(5), 11A(a)(1)(C), 11A(a)(2) and 15A(b)(6) of the Act.

[36] Section 11A(a)(1)(C) and 11A(a)(2) of the Act.

[37] Sections 2, 6(b)(5) and 15A(b)(6) of the Act.

[38] Section 11A(a)(1)(c)(ii) of the Act.

[39] Sections 6(b)(5) and 15A(b)(6) of the Act.

[40] Section 11A(a)(1)(C)(iv) of the Act.

[41] Section 11A(a)(1)(C)(i) of the Act.

[42] Section 11A(a)(1)(C)(v) of the Act.

[43] S. 249 Report, supra note 24, at 8.

[44] Id. at 13.

[45] Sections 6(b)(5), 11A(a)(1)(C), 11A(a)(2) and 15A(b)(6) of the Act.

[46] See 2 SEC, "Special Study of Securities Markets," H.R. Doc. No. 95, 88th Cong., 1st Sess. 14 (1963) ("Special Study"), which states: "Fair" and "honest" presumably encompass the notion of freedom from manipulative and deceptive practices of all kinds and may be regarded as positive expressions of the Act's ban on such practices, acts and devices. "Fair" also presumably implies, especially in the several references to "fair dealing" and also the reference to "unfair discrimination between customers of issuers, or brokers or dealers," that there be no undue advantage or preference among participants in the marketplace, i.e., that there be no unnecessary discrimination in opportunity or treatment or in access to facilities or information. As among participants within any properly recognized category those making similar uses of, contributions to, and demands upon the market facilities—discrimination would be altogether unacceptable. As between different categories—where different uses, contributions, or demands might appropriately be recognized—differences in opportunity and treatment would be held to the absolute minimum consistent with the recognized differences. In short, a market which permitted any unwarranted discriminations would not be considered "fair" in the fullest sense. [Footnotes omitted.]

[47] "Orderly" presumably implies efficiency and economy of operations, but also embraces concepts of regularity and reliability of operation—"a market which does not 'fold up' when the pressure on dealers becomes 'too heavy'" and the concept of avoidance of wide price swings within relatively short spans of time. In the sense of efficiency, "orderly" might include the degree of assurance, through available market mechanisms, that the highest bidders and lowest offerors do not miss each other to the disadvantage of both. In the sense of avoidance of wide price swings, "orderly" shades into and perhaps encompasses the concept of "continuity," discussed below; but whereas the latter term puts emphasis on price constancy from transaction to transaction, "orderly" may also imply constancy over periods of days or weeks, i.e., a degree of stability. However, neither of these latter concepts is explicitly set forth in the statute, as a definition of "orderly" or otherwise. [Footnote omitted.] Id. at 15.

[48] Section 2 of the Act.

[49] See e.g., Sections 6(b)(5) and 15A(b)(6) of the Act.

[50] See Securities Exchange Act Release No. 11815 (November 10, 1975), 40 F.R. 53085 November 14, 1975).

[51] The provisions of the proposed MRR would not have applied to any of the following transactions:

(i) Any transaction which is part of a primary distribution by an issuer, or a registered or unregistered secondary distribution, effected off the Floor of the Exchange;

(ii) Any transaction made in reliance on Section 4(2) of the Securities Act of 1933;

(iii) Any trade at a price unrelated to the current market for the security to correct an error or to enable the seller to make a gift;

(iv) Any transaction pursuant to a tender offer;

(v) Any purchase or sale of securities effected upon the exercise of an option pursuant to the terms thereof or the exercise of any other right to acquire securities at a pre-established consideration unrelated to the current market for such securities;

(vi) Any purchase or sale of any security, trading in which has been suspended by the Exchange pending review of the listing status of such security;

(vii) The acquisition of securities by a member organization as principal in anticipation of making an immediate special offering of exchange distribution on the Exchange under Rule 391 or Rule 392;

(viii) Any purchase or sale of any of the guaranteed or preferred stocks included within the listing of such stocks as may from time to time be issued by the Exchange: *Provided, however*, That every proposed transaction in any such security by a member, member organization or affiliated person should be reviewed in light of factors involved, including the market on the Floor of the Exchange, the price and the size so that whenever possible the transaction may be effected on the Floor; and

(ix) Any other purchase or sale of any security under extraordinary or emergency conditions which receives the prior approval of the Exchange. Id.

[52] Proceeding Transcript, supra note 12, at 26 (APAM) passim.

[53] Id. at 767 passim (SIA).

[54] Id. at 944 passim (MSE).

[55] See September Report, supra note 2, at 16–20 and Appendix C thereto.

[56] See Proceeding Transcript, supra note 12, at 18–20 (APAM). See also Comments of the United States Department of Justice in the Matter of Proposals to Amend or Abrogate Off-Board Trading Rules of National Securities Exchanges (November 10, 1975), Commission File No. 4–180 (1975) ("Justice Comments").

[57] 17 CFR 240.17a–15.

[58] See, e.g., Policy Statement, supra note 14, at 42–43.

[59] Proceeding Transcript, supra note 12, at 122 (Source Securities); and at 420, 464–65 (Weeden). See also Exhibit 4 to the Testimony of Weeden & Co., Memorandum on a Comparison of Third Market Transaction Prices with New York Stock Exchange Quotation Prices, introduced during the October Hearings.

[60] Proceeding Transcript, supra note 12, at 1120(NYSE); cf. id. at 718 (Treasury).

[61] Id. at 420 (Weeden).

[62] See 17 CFR 240.11b–1, NYSE Rule 104 and Amex Rule 170.

[63] Proceeding Transcript, supra note 12, at 531 (Morgan Stanley).

[64] Id. at 122 (Source Securities); and at 420 (Weeden).

[65] Cf. id. at 414, 451–54, 486 (Weeden), and Justice Comments, supra note 56, at 18. Contra, Proceeding Transcript, supra note 12, at 195 (PSE); at 971 (MSE); and at 1099 (NYSE).

[66] Proceeding Transcript, supra note 12, at 42–43, 70–71 (APAM); at 270, 330–31 (Merrill Lynch); at 373 (INA); at 762 (SIA); at 869 (Amex); and at 1095, 1139 (NYSE).

[67] Id., at 15, 81–82 (APAM); at 165 (SOA); at 270a–71a, 330 (Merrill Lynch); at 372, 392–93 (INA); at 517, 550 (Morgan Stanley); at 659–60, 668–70, 683 (BSE); at 762–63 (SIA); and at 1084, 1095–97, 1139, 1140 (NYSE).

[68] Id. at 12 (APAM); at 161–66 (SOA); at 391–92 (INA); at 561 (NAIC); at 764 (SIA); and at 976–79 (MSE).

[69] Id. at 20–21 (APAM); at 391–92 (INA); at 791–93 (SIA); at 904 (Amex); and at 976–79 (MSE).

[70] Id. at 22–23, 83 (APAM); at 271a, 292, 329–30 (Merrill Lynch); at 561 (NAIC); at 762–65, 815 (SIA); at 830, 847 (Amex); at 1086–87 (NYSE). Contra, Id. at 505–06 (Weeden).

[71] Id. at 518 (Morgan Stanley); at 606, 624, 640 (Ad Hoc Committee); and at 763 (SIA).

[72] See notes 67–69 supra.

[73] In re Rules of the New York Stock Exchange, 10 SEC 270 (1941).

[74] An exception would be competition for large block transactions, where it is acknowledged that well-capitalized firms have a distinct advantage over firms of lesser financial means because of their ability to "position" portions of blocks for their own accounts when necessary to complete block trades.

[75] This is so even if it is assumed that substantial order centralization and existing mechanisms for equalizing brokerage opportunities are attributable to those rules.

[76] Sporadic off-board principal trades by exchange members either to "position" a portion of a block or to acquire or dispose of an investment position would not appear to contribute materially to market fragmentation.

[77] Such protection might be afforded, for example, by prohibiting market makers from dealing directly (instead of through a broker) with non-professional, non-institutional customers, or by requiring the prices at which transactions with such customers are effected to be no less favorable than those which the firm knew or ought to have known could have been obtained for those customers if the firm had been acting in an agency capacity. See September Report, supra note 21, at 34–35.

[78] See Section 11A(a)(1)(C) of the Act.

[79] See Section 11A(a)(1)(C)(ii) of the Act.

[80] See Sections 11A(a)(1)(C)(iii)–(iv) of the Act.

[81] See Section 11A(a)(1)(C)(v) of the Act. Such an opportunity, of course, presently exists by means of the specialist's limit order book.

[82] See text accompanying notes 155–172, infra.

[83] An example is Rule 11b–1 under the Act (17 CFR 240.11b–1) (affecting only "primary" exchange specialists because over-the-counter market makers are not covered by the Rule), and rules of certain exchanges (such as NYSE Rule 104 and Amex Rule 170).

[84] NYSE Rule 113. See Policy Statement, supra note 14 at 42–46 and the September Report, supra note 2, at 20.

[85] NYSE Rule 104.

[86] Cf. Chicago Board Options Exchange, Rule 8.7.

[87] Examples are so-called "negative obligations," which prohibit certain specialist purchases from or sales to his limit order book, which bar specialists from dealing regularly in a destabilizing manner, and which prevent these specialists from dominating trading.

[88] See text accompanying notes 155–172, infra.

[89] The National Market Advisory Board ("NMAB") was established on September 30, 1975, pursuant to Section 11A(d)(1) of the Act.

[90] See text accompanying note 154, infra.

[91] The Commission wishes to stress that all of the arguments presented at the October Hearings and by commentators in favor of preserving exchange off-board trading rules governing principal transactions were addressed solely to the potential adverse consequences of permitting members to engage in round-lot transactions (particularly as market makers) in the over-the-counter market. The Commission's agreement with certain of the concerns expressed, to the extent indicated above, is confined to such transactions. Thus, for example, the reasons which have persuaded the Commission to permit, for the present time, retention of exchange rules barring members from effecting round-lot transactions in exchange-listed securities over-the-counter have no application to off-board transactions in odd-lots. Any construction of existing off-board trading rules which would prevent exchange

members from effecting odd-lot transactions in exchange-listed securities off-board would represent the imposition of burdens on competition which cannot be justified by reference to the purposes of the Act.

92 Such rules, as a prerequisite to consummation of an over-the-counter agency transaction, either require exchange members to obtain permission from the exchange (e.g., PBW Rule 132, which also requires a "bona fide effort to effect transactions on the Exchange") or compel exchange members to follow procedures of sufficient difficulty to inhibit them from attempting such executions (e.g., NYSE Rule 394(b), requiring compliance with elaborate and time-consuming procedures). See September Report, supra note 2, at 23-24.

93 *Id.* at 2, 23. A complete description of exchange off-board trading rules affecting agency transactions is set forth in the September Report at 2-10. The ways in which those rules function are discussed in Appendices A and C to the September Report.

94 *Id.* at 38. Contra, Proceeding Transcript, supra note 12, at 178 (SOA); at 373 (INA); and at 767 (SIA). Of course, any mechanism for displacement of certain orders by others (e.g., by requiring satisfaction of public limit orders entered in a central electronic limit order repository) would have the effect of subordinating the interest of certain customers to those of others; but a national mechanism to perform this function would not have the effect of preventing brokers, as a practical matter, from seeking the most favorable executions available in any market center.

95 September Report, supra note 2, at 6-10. See also Appendix C thereto.

96 *Id.* at 6-10 and Appendix C thereto, at C-13-14, 17, 19.

97 *Id.* at 6-10 and Appendix C thereto, at C-21-29.

98 See Proceeding Transcript, supra note 12.

99 Id.

100 See September Report, supra note 2, at 22, and Appendix C thereto, at C-18; Proceeding Transcript, supra note 12, at 675 (BSE); at 742 (Treasury); at 785, 804-07 (SIA); at 1032-33 (MSE); and at 1354, 1362 (Oppenheimer).

101 Proceeding Transcript, supra note 12, at 233 (PSE); at 695 (BSE); at 742 (Treasury); at 900 (Amex); at 1046-47 (MSE); at 1409 (Oppenheimer); and at Exhibit 2 to the Testimony by Merrill Lynch at 30-31, Commission File No. 4-180 (1975).

102 For discussion of certain rules introduced during the course of the October Hearings, see text accompanying notes 50-54, supra.

103 Id. See Proceeding Transcript, supra note 12, at 27, 56-57, 100, 102-03, 105-06 (APAM); at 945-52, 962-64 (MSE); and at 1113-14 passim (NYSE).

104 Id.

105 See generally September Report, supra note 2, and Appendix B thereto.

106 Id.

107 Proceeding Transcript, supra, note 12, at 372 (INA); at 829-31 (Amex); at 558 (NAIC); and at 1092, 1204 (NYSE). Cf. id. at 942-43 (MSE).

108 See September Report, supra note 2, at 19, 23 and Appendix C thereto to C-20-29, for a discussion of rules of various regional exchanges which permit over-the-counter market makers to become members and make markets on those exchanges while continuing to make markets over-the-counter; Proceeding Transcript, supra note 12, at 18, 55 (APAM); at 235 (PSE); and at 828, 938-39 (Amex). Cf. id. at 419-20 (Weeden); at 665 (BSE); at 536-37 (Morgan Stanley); at 236 (PSE); and at 343 (Merrill Lynch).

109 Proceeding Transcript, supra note 12, at 147 (Source Securities); at 343 (Merrill Lynch); at 828, 843 (Amex); at 1095, 1130-31 (NYSE); and at 1433-34 (Oppenheimer).

110 September Report, supra note 2, at 23.

111 To a certain extent, of course, this also would be true of over-the-counter executions, but the comparative efficiency of over-the-counter executions, at least for some firms, would appear to encourage brokers to consider a direct third market execution in cases where they would not consider a regional exchange execution.

112 Proceeding Transcript, supra note 12, at 587-88, 591 (NAIC); and at 423-24 (Weeden).

113 September Report, supra note 2, at 25.

114 Id. Proceeding Transcript, supra note 12, at 769-70, 778 (SIA); and at 1021-23 (MSE).

115 September Report, supra note 2, at 25.

116 See Release No. 11628, supra note 3, at 27. Proceeding Transcript, supra note 12, at 1026 (MSE).

117 Proceeding Transcript, supra note 12, at 342-43, 354 (Merrill Lynch). Cf. id. at 440-41 (Weeden).

118 September Report, supra note 2, at 24-26.

119 See Sections 11A(a)(1)(C)(i)-(iv) of the Act.

120 Proceeding Transcript, supra note 12, at 39-41, 90 (APAM); at 829, 834, 848 and 869 (Amex); at 372, 374 (INA); at 165 (SOA); at 191-92 (PSE); at 659, 684-85 (BSE); at 292 (Merrill Lynch); at 763-66 (SIA); and at 533-34, 549 (Morgan Stanley). Contra, id. at 111 (Source Securities); and at 420, 443 (Weeden).

121 Id. at 723-24 (Treasury); and at 820 (SIA).

122 Id. at 310-11, 342-43 (Merrill Lynch); at 570 (NAIC); at 796, 804-07, 819-20 (SIA); at 723-24 (Treasury); at 829 (Amex); at 239 (PSE); and at 1200-02 (NYSE). Cf. Justice Comments, supra note 56, at 15.

123 Proceeding Transcript, supra note 12, at 84-85 (APAM); and at 343-44 (Merrill Lynch).

124 See generally Policy Statement, supra note 14, and the Future Structure Statement, supra note 14.

125 See discussion of off-board trading rules governing principal transactions, supra in text accompanying notes 55-91.

126 The NYSE testified that in 1970, approximately 82.5% of all transactions in NYSE-listed securities were effected on the NYSE, 11.1% were effected on the regionals and 6.3% were effected in the third market. In 1975, these figures were 85%, 10.7% and 4.3% respectively. Proceeding Transcript, supra note 12, at 1137 (NYSE).

The Amex testified that approximately 97% of all transactions in Amex-listed securities were effected on the Amex, 1½% on regional exchanges and 1½% in the third market. Id. at 876-77 (Amex).

127 Cf. id. 319 (Merrill Lynch); and 2 Special Study, supra note 46, at 941.

128 Orders of block size generally are arranged "upstairs" by block trading firms at a negotiated price; consequently, the physical location where the order is executed would not appear to be of particular importance for such orders.

129 Proceeding Transcript, supra note 12, at 306 (Merrill Lynch); and at 804-07, 820 (SIA).

130 Id. at 310-11, 342-43 (Merrill Lynch); at 570 (NAIC); at 796, 804-07, 819-21 (SIA); at 723-24 (Treasury); at 829 (Amex); at 239 (PSE); and at 1200-02, 1240, 1267-69, 1273 (NYSE). See Justice Comments, supra note 56.

131 See, e.g., Policy Statement, supra note 14, at 46-48, 57-58, and 63-64.

132 It appears to the Commission that lesser standards for such executions (e.g., last sale on the NYSE) could present significant problems in terms of the fiduciary obligations of firms attempting in-house crossing of agency orders, particularly with respect to disclosures of the potential disadvantages of an in-house execution program.

133 See, e.g., Section 15(c)(5) of the Act.

134 See text accompanying notes 20-22, supra.

135 This might result, for example, from the greater efficiency in effecting a transaction directly with an over-the-counter market maker rather than meeting him on a regional exchange.

136 In this regard the Commission notes that the Pacific Stock Exchange testified that the market maker on their exchange with the largest share volume was an over-the-counter market maker. Proceeding Transcript, supra note 12, at 236 (PSE).

137 Proceeding Transcript, supra note 12, at 194 (PSE); at 668, 706 (BSE); and at 447, 486 (Weeden).

138 Id. at 20-22, 82 (APAM); at 194 (PSE); at 292, 362-65 (Merrill Lynch); at 374 (INA); at 659-60 (BSE); at 764 (SIA); and at 1084, 1140 (NYSE). Contra, Justice Comments, supra note 56, at 20.

139 Policy Statement, supra note 14, at 31-32; 2 Special Study, supra note 46, at 908-09.

140 See text accompanying notes 88-89, supra.

141 Contra, Proceeding Transcript, supra note 12, at 190-91 (PSE); at 308-09 (Merrill Lynch); at 558 (NAIC); at 708 (BSE); at 762-65 (SIA); at 834, 867, 878-79 (Amex); and at 1097 (NYSE).

142 Id. at 36, 49, 91-95 (APAM); and at 716-17 (Treasury). See Exhibit I to the Testimony of the NYSE at the October Hearings, Commission File No. 4-180 (1975).

143 Proceeding Transcript, supra note 12, at 15 passim (APAM); at 192 (PSE); at 270 (Merrill Lynch); at 391-92 (INA); at 518-19, 525-26 (Morgan Stanley); at 659, 685 (BSE); at 715-18 (Treasury); at 762-65 (SIA); at 834 (Amex), and at 1110-11 (NYSE). Contra, Exhibit V to the Testimony of Weeden at the October Hearings, Commission File No. 4-180 (1975).

144 See Proceeding Transcript, supra note 12, at 217-18 (PSE).

145 Thus, for example, the Senate Banking, Housing and Urban Affairs Committee concluded that: A healthy, highly competitive system of market makers is essential to an efficient national market system. Investigations by the Committee have adequately demonstrated that in our increasingly complex and institutional markets a single specialist, regardless of the regulation and exhortation to which he is subject, cannot provide adequate liquidity and continuity to the market for a security. To assure that our markets are able to serve the needs of both individual and institutional investors, the Committee believes many types of market makers are necessary and that encouragement should be given to all dealers to make simultaneous competing markets within the new national system. S. 240 Report, supra note 24, at 14.

146 See e.g., Proceeding Transcript, supra note 12, at 270 (Merrill Lynch); at 561 (NAIC); at 678-79 (BSE); and at 945-58 (MSE).

147 See Policy Statement, supra note 14, at 16-18.

148 Proceeding Transcript, supra note 12, at 86-87 (APAM); at 115 (Source Securities); at 185-86 (PSE); at 270 passim (Merrill

Lynch); at 523-24, 534 (Morgan Stanley); at 675, 680 (BSE); at 759, 764-69 (SIA); at 830 (Amex); at 1017 passim (MSE); and at 1107-08 (NYSE). Cf. Justice Comments, supra note 56, at 20.

[149] It also has been argued that abrogation of exchange rules governing agency transactions would permit the in-house crossing of small orders by large retail firms, and that the initiation of such activity would result in the same kind of fragmentation of the markets discussed supra in connection with continuous "upstairs" round-lot market making. The Commission, however, does not believe this (Footnote continued on following page) development will occur since there appears to be little possibility that in-house crossing of small agency orders will offer cost savings of sufficient size to offset the difficulties and legal risks inherent in "bunching" or queuing market orders in-house and the costs of reprogramming automatic order routing systems to perform this function. Unlike "upstairs" market making, in-house crossing of agency orders would not afford profits from a "jobber's turn."

[150] Proceeding Transcript, supra note 12, at 724 (Treasury) at 456-57 (Weeden); at 759, 766-67 (SIA); and at 944-45, 958 (MSE). Cf. id. at 848, 871, 917 (Amex); and at 1093-94 (NYSE).

[151] Id. at 12 (APAM); at 560-61 (NAIC); at 763 (SIA); and at 1095-96 (NYSE).

[152] Id.

[153] Moreover, as pointed out by the Senate Committee on Banking, Housing and Urban Affairs: To achieve the objectives of a national market system, the private sector, under the supervision of the SEC, will be called upon to develop and operate sophisticated communication and data processing facilities. But the substantial investment that these facilities will require would be wasted if brokers were prevented by restrictive rules and practices from using them to search out the best price for their customers or if dealers were prevented or hindered by unnecessary or inappropriate regulatory requirements or limitations from engaging in market making activities. The Committee therefore believes that the first order of priority in creating a national market system is to break down the unnecessary regulatory restrictions which now impede contact between brokers and market makers and which restrain competition among markets and market makers. S. 249 Report, supra, note 24, at 13.

[154] As indicated above, the Commission believes that not even these interim provisions can be justified as permanent features of the regulatory pattern governing exchange trading.

[155] Proceeding Transcript, supra note 12, at 78 (APAM); at 112 (Source Securities); 163-64 (SOA); at 183 (PSE); at 271 (Merrill Lynch); Exhibit 2 to the Testimony of Merrill Lynch; Commission File No. 4-180 (1975); at 412 (Weeden); at 514 (Morgan Stanley); at 601 (Ad Hoc Committee); at 661 (BSE); at 711 (Treasury); at 759 (SIA); at 851 (Amex); at 943-44 (MSE); at 1073-74 (NYSE); and at 1325-26 (NYC).

[156] See Exhibit 1 to the Testimony of Merrill Lynch and Exhibit 6 to the Testimony of Weeden at the October Hearings, Commission File No. 4-180 (1975).

[157] See, Future Structure Statement, supra note 14, at 8-9.

[158] Securities Exchange Act Release Nos. 11030 (September 27, 1974); 11468 (June 12, 1975).

[159] Securities Exchange Act Release No. 11497 (June 26, 1975).

[160] See Letter from Ray Garrett, Jr., Chairman, SEC, to American Stock Exchange, Inc., Midwest Stock Exchange, Inc., National Association of Securities Dealers, Inc., New York Stock Exchange, Inc., Pacific Stock Exchange, Inc., and PBW Stock Exchange, Inc., September 27, 1974; Securities Exchange Act Release Nos. 11796 (November 5, 1975); 11797 (November 5, 1975); Letter from Robert J. Birnbaum, Vice President, American Stock Exchange, Inc., to Bart Friedman, Special Counsel, Division of Market Regulations, SEC, September 22, 1975.

[161] See Securities Exchange Act Release No. 10787 (May 10, 1974).

[162] See Securities Exchange Act Release Nos. 11288 (March 11, 1975); 11406 (May 7, 1975).

[163] 17 CFR 240.19b-3.

[164] Securities Exchange Act Release No. 11203 (January 23, 1975).

[165] 17 CFR 240.19c-1.

[166] See Section 11A(a)(1)(C) of the Act.

[167] For example, under the rules of the NYSE, the bid and offer which is first in time has "priority" and is entitled to the first execution at a given price. However, if orders are placed simultaneously, the order of execution is determined by the principle of "precedence", which provides that bids or offers are to be executed in order of size. Since when an execution occurs, all other orders on the floor awaiting execution lose their priority and are treated as if they all arrived simultaneously—thereby triggering the principal of precedence in size—a small limited price order entered weeks ago is generally executed behind larger orders even if the larger orders are entered later in time. See 2 Special Study, supra note 46, at 41.

[168] During the course of our October Hearings, a number of witnesses endorsed the concept of a composite book. See, e.g., Proceeding Transcript, supra note 12, at 115 (Source Securities); at 185-87 (PSE); at 281, 288-90, 332-33, 366 (Merrill Lynch); at 448-52, 502-03 (Weeden); at 593-96 (NAIC); 678-79 (BSE); at 712-13, 727-28 (Treasury); at 785-87, 821-23 (SIA); and at 945-46, 948-49, 996-99, 1001-03 (MSE). In addition, one exchange, the Midwest Stock Exchange, has submitted a plan for the development of a consolidated book system. See Letter from John G. Weithers, Executive Vice-President, Midwest Stock Exchange, to Robert C. Lewis, Deputy Director, Division of Market Regulation, SEC, November 26, 1975. These proposals have proved extremely helpful in our formulation of a program for the achievement of a composite book.

[169] Although it has been suggested that public orders other than those entered on the book, such as "not-held" orders in the crowd, should also be protected, the Commission cannot envisage at this time a method of protecting bids and offers other than those which are firm at a disclosed price and size. See Policy Statement, supra note 14, at 18-20. The Commission believes that only one inquiry should have to be made by a broker holding a customer's order, and that a requirement that a broker go to more than one place to expose his order to other potential buyers or sellers would be impractical and inefficient. The practical difficulties posed by any requirement that a broker do more than check one central location (e.g., a composite book) to determine the extent of any displacement in connection with attempting an execution, especially with relatively small orders, are in part the basis for the Commission's determination not to require that all existing books be cleared before an order could be executed at an inferior price in any market. See September Report, supra note 2, at 45.

[170] For purposes of the proposed rule, the term "specialist" shall include any alternate specialist or other exchange market maker; the term "qualified third market maker" shall have the same meaning as in Rule 17a-16 under the Act (17 CFR 240.17a-16).

[171] The Commission will also consider authorizing a joint venture of all national securities exchanges and the NASD pursuant to its authority under Section 11A(a)(3)(B) of the Act.

[172] See Sections 11A(b) and 11A(c)(1) of the Act; S. 249 Report, supra note 24, at 11-12.

[173] Pub. L. 73-291, 48 Stat. 881 (15 U.S.C. 78) ("Act"), and particularly Secs. 2, 3, 6, 11, 17, 19, 23, Pub. L. 73-291, 48 Stat. 881, 882, 885, 891, 897, 901 (15 U.S.C. 78b, 78c, 78f, 78k, 78q, 78s, 78w) thereof; Sec. 7, Pub. L. 94-29, 89 Stat. 111 (15 U.S.C. 78k-1).

[174] In determining to permit an exchange to mandate participation in a proposed off-board agency execution only by limit orders, the Commission is in large measure relying upon brokers to exercise their professional judgment in determining whether a specialist or other buyers and sellers represented on the floor should participate in a particular order. Moreover, if the bids or offers of the specialist or of customers represented in the crowd are competitive, the Commission believes that each should continue to participate in a large portion of the order flow brought to the floor of an exchange, as they do today. The Commission sought to keep to an absolute minimum the limitations which could be imposed on a broker's ability to exercise his professional judgment in pursuing the most favorable opportunities possible under prevailing market conditions for the execution of his customer's order.

[175] Dissenting statement of Commissioner filed as part of the original document.

APPENDIX—LEGISLATIVE CONSIDERATION OF OFF-BOARD TRADING RULES

The Congressional concern over the impact of exchange off-board trading rules originated with certain studies of the United States securities markets undertaken by the Congress after passage of the Securities Investor Protection Act of 1970. Those studies were conducted by the House Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce[1] and the Senate Subcommittee on Securities of the Committee on Banking, Housing and Urban Affairs.[2] The studies examined, in detail, the development and operation of the securities markets, and, among other things, analyzed the impact of exchange off-board trading rules.

The dominant theme of the reports issued after the conclusion of these studies was a reaffirmation of the benefits that would accrue from increased competition in the industry. The Senate Study stated that public investors: * * * are entitled to the benefits of the present combination of markets, freed of the restrictions which distort the allocation of orders and deprive them of best execution of their transactions. The efforts of government and industry in this area should be directed, not to the creation of barriers between different groups of participants in the securities markets, but to the elimination of barriers which presently impede their communication and competition.[3]

The Subcommittee was of the view that competition, and the addition of increased market-making capacity, would add depth, liquidity and stability to the securities markets. The Senate Study concluded its chapter on the Structure of the Securities Markets with the following recommendation:

The Subcommittee therefore recommends that Rule 394 be amended, either by the NYSE on its own initiative or at the direction of the SEC, to permit exchange members to deal net with third market-makers, without prior permission of the Exchange, subject to a requirement that public orders be given priority in the actual consummation of the transaction.[4]

Following publication of the Senate Study, S. 2519 and S. 3126 were introduced in the Senate on October 2, 1973, and March 7, 1974, respectively. The substance of S. 3126 ultimately was incorporated into S. 2519 and four other Senate bills contemplating amendments to the Securities Exchange Act of 1934 (the "Act") were combined and reintroduced in January, 1975, as S. 249.

While a primary goal of S. 249 was the introduction of greater competition into the securities markets, S. 249 did not provide for the elimination of any particular enumerated rules. Rather, Section 27(b) of the bill would have required the Commission to review present rules of national securities exchanges to ensure that they were in compliance with applicable requirements of the Act, including requirements that such rules do not place any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.[5]

The Report of the Committee on Banking, Housing and Urban Affairs to accompany S. 249 to the U.S. Senate (April 14, 1975) stated that the removal of unnecessary regulatory restrictions was important since:

In the Committee's view the fundamental goals of a national market system must include (1) providing an investor or his broker with the ability to be able to determine, at any given time, where a particular transaction can be effected at the most favorable price and (2) creating an incentive for multiple market makers to deal in depth on a continuous basis.[6]

The Committee indicated its view that competition between individual firms, as well as the various exchange and over-the-counter markets, would be "a critical element in the successful functioning of the national market system."[7] The elimination of restrictions which impede contact between brokers and markets, and which restrain competition among markets and market makers was necessary to assure that "the total market for each security" would be "as liquid and orderly as the characteristics of that security warrant," and that "investors [w]ould be able to obtain the best execution of their orders."[8]

The Committee was concerned that: * * * the substantial investment that these facilities [sophisticated communication and data processing equipment] will require would be wasted if brokers were prevented by restrictive rules and practices from using them to search out the best price for their customers or if dealers were prevented or hindered by unnecessary or inappropriate regulatory requirements or limitations from engaging in market making activities.[9]

In its report on the Securities Industry Study, the House Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce emphasized the salutory effects that would be achieved by the introduction of additional competition into the securities markets.

The House Report stated: A review of the Subcommittee's record convinces us that in the securities industry undue emphasis has been placed on regulation instead of competition. We find that such emphasis has been unwarranted. The Subcommittee finds that in the economic areas affecting the securities industry, competition, rather than regulation, should be the guiding force. We have proposed, therefore, in other chapters of the report, to abolish the fixed minimum commission rate system; to open up membership on registered national securities exchanges to all registered broker-dealers who meet applicable capital and competency requirements; to prohibit boycotts such as New York Stock Exchange rule 394 and to provide for competition among market makers, including specialists. We find that at least in these areas competition rather than regulation, should control.[10]

The approach taken by the House Study differed somewhat from the Senate Study in that the House recommended the immediate abrogation of off-board trading rules as an unjustified inhibition to competition between markets.

The Subcommittee concluded that: In a central market system whose objectives are that customers should receive the best possible execution of their orders in any market wherever situated and that such orders be transacted at the lowest possible cost, rule 394 has no justification. Accordingly, the New York Stock Exchange should immediately rescind the rule. If this is not done the Subcommittee will introduce legislation which will have the effect of abrogating the rule. It may be argued that any action on rule 394 should be delayed until the central market system becomes a reality, for at that time the concept of 'off-board trading' would disappear. The subcommittee disagrees. The development of a central market system may take a number of years, and rule 394 should not be allowed to continue during that period of time.[11]

The recommendations of the House Study were embodied in H.R. 5050, introduced on March 1, 1973, in the 93d Congress. While H.R. 5050 failed to pass the 93d Congress, a bill virtually identical to it, at least insofar as provisions concerning the development of a national market system are concerned, was introduced on January 14, 1975, at the start of the 94th Congress.[12]

Like its Senate counterpart, H.R. 4111 emphasized the importance of introducing greater competition into the securities markets.[13] The House bill departed from the approach taken by S. 249, however: Section 501 of H.R. 4111 would have added a new section 20B to the Act, mandating the elimination of exchange rules which limit or condition the ability of a member to transact business on any other exchange or otherwise than on an exchange by a date certain unless the rule was specifically approved by the Commission.[14]

The Committee Report to accompany H.R. 4111 explained this provision of the bill and focused on what the Committee viewed as the substantial and unjustifiable burden on competition that rules such as NYSE Rule 394 represent.[15]

[A]n overriding and fundamental purpose of this legislation is to strengthen our capital markets by removing artificial barriers to competition which impede market efficiency and unnecessarily interfere with the evolution of a national market system. The Committee's goal is to create a regulatory structure which assures that investors will be able to obtain the most favorable price for securities and that market liquidity is maximized through open competition among multiple market makers.

Among the more significant barriers to competition between market makers have been the New York Stock Exchange's Rule 394.

* * * * *

* * * After considerable study, the Committee has concluded that existing Rule 394 constitutes a practical prohibition on trading 'off the Exchange' which should be abrogated.

The Committee's condemnation of existing Rule 394 does not constitute a determination that any rule of an exchange which places limitations on a member's ability to select markets cannot be justified. There may be circumstances pursuant to which exchange-imposed limitations designed to assure protection of public orders may be supported as necessary to insure the integrity of the pricing mechanism of the auction market and thus be found valid. In such instances a legitimate concern of the exchange community may be found to coincide with the public interest.[16]

S. 249 and H.R. 4111 passed the Senate and the House on April 17, 1975, and April 24, 1975, respectively. The Conference Committee on these two bills generally adopted the provisions of the Senate Bill concerning the Commission's obligation to remove existing burdens on competition and to refrain from imposing, or permitting to be imposed, any competitive restraint neither necessary or appropriate in furtherance of the purposes of the Act.[17] Significantly, however, the Conference Committee adopted a specific provision (section 11A(c)(4)(A) of the Act) for review of exchange rules which limit or condition the ability of members to effect transactions otherwise than on such exchanges.

FOOTNOTES

[1] Subcommittee on Commerce and Finance, House Committee on Interstate and Foreign Commerce, "Securities Industry Study Report," H.R. No. 92–1519, 92d Cong., 2d Sess. (1972).

[2] Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, "Securities Industry Study Report," S. Doc. No. 93–13, 93d Cong., 1st Sess. (1973).

[3] Id. at 96.

[4] Id. at 105.

[5] S. 249, § 27(b), 94th Cong., 1st Sess. (1975). See also id., section 4.

[6] Senate Committee on Banking, Housing and Urban Affairs, "Report on the Securities Acts Amendments of 1975 to Accompany S. 249," S. Rep. No. 94–75, 94th Cong., 1st Sess. 12 (1975).

[7] Id. at 13.

[8] Id. at 12.

[9] Id.

[10] Subcommittee on Commerce and Finance, House Committee on Foreign Commerce, "Securities Industry Study Report," H.R. Rep. 92–1519, 92d Cong., 2d Sess. viii (1972).

[11] Id. at 127.

[12] H.R. 10, 94th Cong., 1st Sess. (1975).

[13] House Committee on Interstate and Foreign Commerce. "Report on the Securities Reform Act of 1975 to Accompany H.R. 4111," H.R. Rep. No. 94–123, 94th Cong., 1st Sess. 47–8 (1975).

[14] H.R. 4111, section 501, 94th Cong., 1st Sess. (1975). H.R. 4111, which contained identical provisions with respect to the development of a national market system, as did H.R. 10, was introduced on March 3, 1975.

[15] House Committee on Interstate and Foreign Commerce, "Report on the Securities Reform Act of 1975 to Accompany H.R. 4111," H.R. Rep. 94–123, 94th Cong., 1st Sess., 93–5 (1975).

[16] Id. at 93–4.

[17] Committee of Conference, "Conference Report to Accompany S. 249," H.R. Rep. No. 94–229, 94th Cong., 1st Sess., 95 (1975).

[FR Doc. 76–2753 Filed 1–29–76;8:45 am]

Title 21—Food and Drugs

CHAPTER II—DRUG ENFORCEMENT ADMINISTRATION, DEPARTMENT OF JUSTICE

PART 1308—SCHEDULES OF CONTROLLED SUBSTANCES

Exempt Chemical Preparations

Correction

In FR Doc. 76–2006, appearing at page 3287 in the issue for Thursday, January 22, 1976, the following change should be made:

The first line of text in the first column immediately below the table on page 3288 should read "Effective date. This order is effective January 22, 1976".

Title 24—Housing and Urban Development

CHAPTER II—OFFICE OF ASSISTANT SECRETARY FOR HOUSING PRODUCTION AND MORTGAGE CREDIT-FEDERAL HOUSING COMMISSIONER [FEDERAL HOUSING ADMINISTRATION]

[Docket No. R–76–372]

DEBENTURE INTEREST RATES

The following amendments have been made to this chapter to change the debenture interest rate. The Secretary has determined that advance publication and notice and public procedure are unnecessary since the debenture interest rate is set by the Secretary of the Treasury in accordance with a procedure established by statute and that good cause exists for making this amendment effective on January 1, 1976.

Accordingly, Chapter II is amended as follows:

PART 203—MUTUAL MORTGAGE INSURANCE AND INSURED HOME IMPROVEMENT LOANS

Subpart B—Contract Rights and Obligations

1. Section 203.405 is revised to read as follows:

§ 203.405 Debenture interest rate.

Debentures shall bear interest from the date of issue, payable semi-annually on the first day of January and the first day of July of each year at the rate in effect as of the date the commitment was issued, or as of the date the mortgage was endorsed for insurance, whichever rate is higher. The following interest rates are effective for the dates listed:

Effective rate (percent)	On or after—	Prior to—
6⅛	Jan. 1, 1971	July 1, 1971
5⅞	July 1, 1971	Jan. 1, 1972
5⅝	Jan. 1, 1972	July 1, 1972
5½	July 1, 1972	Jan. 1, 1973
5¼	Jan. 1, 1973	July 1, 1973
6	July 1, 1973	Jan. 1, 1974
6¼	Jan. 1, 1974	July 1, 1974
6⅝	July 1, 1974	July 1, 1975
7	July 1, 1975	Jan. 1, 1976
7⅛	Jan. 1, 1976	

(Sec. 211, 52 Stat. 23; 12 U.S.C. 1715b. Interprets or applies sec. 203, 52 Stat. 10, as amended; 12 U.S.C. 1709)

2. Section 203.479 is revised to read as follows:

§ 203.479 Debenture interest rate.

Debentures shall bear interest from the date of issue, payable semiannually on the first day of January and the first day of July of each year at the rate in effect as of the date the commitment was issued, or as of the date the loan was endorsed for insurance, whichever rate is the higher. The following interest rates are effective for the dates listed:

Effective rate (percent)	On or after—	Prior to—
6⅛	Jan. 1, 1971	July 1, 1971
5⅞	July 1, 1971	Jan. 1, 1972
5⅝	Jan. 1, 1972	July 1, 1972
5½	July 1, 1972	Jan. 1, 1973
5¼	Jan. 1, 1973	July 1, 1973
6	July 1, 1973	Jan. 1, 1974
6¼	Jan. 1, 1974	July 1, 1974
6⅝	July 1, 1974	July 1, 1975
7	July 1, 1975	Jan. 1, 1976
7⅛	Jan. 1, 1976	

(Sec. 211, 52 Stat. 23; 12 U.S.C. 1715b. Interprets or applies sec. 203, 52 Stat. 10, as amended; 12 U.S.C. 1709)

PART 207—MULTIFAMILY HOUSING MORTGAGE INSURANCE

Subpart B—Contract Rights and Obligations

In § 207.259 paragraph (e)(6) is revised to read as follows:

§ 207.259 Insurance benefits.

* * * * *

(e) *Issuance of debentures.* * * *

(6) Bear interest from the date of issue, payable semiannually on the first day of January and first day of July of each year at the rate in effect as of the date the commitment was issued, or as of the date of initial insurance endorsement of the mortgage, whichever rate is the higher. The following interest rates are effective for the dates listed:

Effective rate (percent)	On or after—	Prior to—
6⅛	Jan. 1, 1971	July 1, 1971
5⅞	July 1, 1971	Jan. 1, 1972
5⅝	Jan. 1, 1972	July 1, 1972
5½	July 1, 1972	Jan. 1, 1973
5¼	Jan. 1, 1973	July 1, 1973
6	July 1, 1973	Jan. 1, 1974
6¼	Jan. 1, 1974	July 1, 1974
6⅝	July 1, 1974	July 1, 1975
7	July 1, 1975	Jan. 1, 1976
7⅛	Jan. 1, 1976	

* * * * *

(Sec. 211, 52 Stat. 23; 12 U.S.C. 1715b. Interprets or applies sec. 207, 52 Stat. 16, as amended; 12 U.S.C. 1713)

PART 220—URBAN RENEWAL MORTGAGE INSURANCE AND INSURED IMPROVEMENT LOANS

Subpart D—Contract Rights and Obligations—Projects

Section 220.830 is revised to read as follows:

§ 220.830 Debenture interest rate.

Debentures shall bear interest from the date of issue, payable semiannually on the first day of January and the first day of July of each year at the rate in effect as of the date the commitment was issued, or as of the date the loan was endorsed for insurance, whichever rate is higher. The following interest rates are effective for the dates listed:

Effective rate (percent)	On or after—	Prior to—
6⅛	Jan. 1, 1971	July 1, 1971
5⅞	July 1, 1971	Jan. 1, 1972
5⅝	Jan. 1, 1972	July 1, 1972
5½	July 1, 1972	Jan. 1, 1973
5¼	Jan. 1, 1973	July 1, 1973
6	July 1, 1973	Jan. 1, 1974
6¼	Jan. 1, 1974	July 1, 1974
6⅝	July 1, 1974	July 1, 1975
7	July 1, 1975	Jan. 1, 1976
7⅛	Jan. 1, 1976	

(Sec. 211, 52 Stat. 23; 12 U.S.C. 1715b. Interprets or applies sec. 220, 68 Stat. 596, as amended; 12 U.S.C. 1715k)

Effective date. These amendments are effective as of January 1, 1976.

(It is hereby certified that the economic and inflationary impact of this regulation has been carefully evaluated in accordance with OMB A–107.)

DAVID S. COOK,
Assistant Secre ary-Commissioner for Housing Production and Mortgage Credit.

[FR Doc.76–2739 Filed 1–29–76;8:45 am]

CHAPTER X—FEDERAL INSURANCE ADMINISTRATION

SUBCHAPTER B—NATIONAL FLOOD INSURANCE PROGRAM

[Docket No. FI–697]

PART 1916—CONSULTATION WITH LOCAL OFFICIALS

Changes Made in Determinations of Jefferson Parish, Louisiana, Base Flood Elevations

On October 13, 1971, at 36 FR 19909, the Federal Insurance Administrator published a list of communities with Special Flood Hazard Areas and the map numbers and locations where Flood Insurance Rate Maps were available for public inspection. The list included Flood Insurance Rate Maps for portions of Jefferson Parish.

The Federal Insurance Administrator, after consultation with the Chief Executive Officer of Jefferson Parish, has determined that modification of the base (100-year) flood elevations of some locations in Jefferson Parish, Louisiana, is appropriate. These modified elevations are currently in effect and amend the Flood Insurance Rate Map. A revised rate map will be published as soon as possible. The modifications are made pursuant to Section 206 of the Flood Disaster Protection Act of 1973 (Pub. L. 93–234) and are in accordance with the National Flood Insurance Act of 1968, as amended, (Title XIII of the Housing and Urban Development Act of 1968, Pub. L. 90–448) 42 U.S.C. 4001–4128, and 24 CFR Part 1916.

For rating purposes, the new community number is 225199B and must be used for all new policies and renewals.

The changes in base flood elevations are as follows:

Previous Flood Insurance Act zones (as on map)	Previous base flood elevations (as on map) (mean sea level)	New Flood Insurance Act zones	New base flood elevations (mean sea level)
Zone A2	2	Zone A4	1.5

These changes apply only to the following areas:

1. Marrero Industrial Subdivision, Section A, as recorded in Plan Book 40 at Folio 32;

2. Marrero Industrial Subdivision, Section B, as recorded in Plan Book 55 at Folio 27;

3. Marrero Industrial Subdivision, Addition to Section B, as recorded in Conveyance Book 794 at Folio 902; all in the Office of the Deputy Clerk of the 24th Judicial District Court in and for the State of Louisiana, Parish of Jefferson.

Under the above mentioned Acts of 1968 and 1973 the Administrator must develop criteria for flood plain management. In order for the community to continue participation in the National Flood Insurance Program, the community must use the modified elevations to carry out the flood plain management measures of the Program. These modified elevations will also be used to calculate the appropriate flood insurance premium rates for new buildings and their contents and for the second layer of insurance on existing buildings and contents.

From the date of this notice, any person has 90 days in which he can request through the community that the Federal Insurance Administrator reconsider the changes. Any request for reconsideration must be based on knowledge of changed conditions or new scientific and technical data. All interested parties are on notice that until the 90-day period elapses, the Administrator's new determination of elevations may itself be changed.

Any person having knowledge or wishing to comment on these changes should immediately notify:

Director of Planning, Jefferson Parish, 3300 Metairie Road, Metairie, Louisiana 70001

(National Flood Insurance Act of 1968 (Title XIII of the Housing and Urban Development Act of 1968); effective January 28, 1969 (33 FR 17804; November 28, 1968), as amended; 42 U.S.C. 4001–4128; and Secretary's delegation of authority to the Federal Insurance Administrator, 34 FR 2680, February 27, 1969, as amended 39 FR 2787, January 24, 1974.)

Issued: December 23, 1975.

J. ROBERT HUNTER,
Acting Federal Insurance Administrator.

[FR Doc.76-2740 Filed 1-29-76;8:45 am]

[Docket No. FI-844]

PART 1917—APPEALS FROM FLOOD ELEVATION DETERMINATION AND JUDICIAL REVIEW

Proposed Flood Elevation Determination for Township of Upper, Cape May County, N.J.

The Federal Insurance Administrator, in accordance with Section 110 of the Flood Disaster Protection Act of 1973 (P.L. 93–234), 87 Stat. 980, which added Section 1363 to the National Flood Insurance Act of 1968 (Title XIII of the Housing and Urban Development Act of 1968 P.L. 90–448), 42 U.S.C. 4001–4128, and 24 CFR Part 1917 (§ 1917.4(a)) hereby gives notice of his proposed determinations of flood elevations for the Township of Upper, New Jersey.

Under these Acts, the Administrator, to whom the Secretary has delegated the statutory authority, must develop criteria for flood plain management in identified flood hazard areas. In order to participate in the National Flood Insurance Program, the Township must adopt flood plain management measures that are consistent with the flood elevations determined by the Secretary.

Proposed flood elevations (100-year flood) are listed below for selected locations. Maps and other information showing the detailed outlines of the flood-prone areas and the proposed flood elevations are available for review at the Township Hall, Tuckahoe, New Jersey 08250.

Any person having knowledge, information, or wishing to make a comment on these determinations should immediately notify Allen Bergh, Township Commissioner, Township Hall, Tuckahoe, New Jersey 08250. The period for comment will be ninety days following the second publication of this notice in a newspaper of local circulation in the above-named community or ninety days from publication of this notice in the FEDERAL REGISTER, whichever is the later.

The proposed 100-year Flood Elevations are:

Source of flooding	Location	Elevation in feet above mean sea level	Width in feet from shoreline or bank of stream (facing downstream) to the 100-yr flood boundary	
			Left	Right
Tuckahoe River	Garden State Parkway	9	(1)	2,300
	Highway 9	9	(1)	600
	Dennisville Rd	9	(1)	600
	Pennsylvania-Reading Seashore RR	9	(1)	25
	Highway 49	9	(1)	150
Cedar Swamp Creek	Highway 50	9	1,850	1,850
	Tuckahoe Rd	9	4,100	6,050
Atlantic Ocean	Tyler Rd (extended)	9	4,100	4,100
	Pennsylvania-Reading Seashore RR	9	[2] 6,700	[2] 6,700
	Roosevelt Blvd	9	[2] 5,600	[2] 5,600

[1] Corporate limits.
[2] From corporate limits.

(National Flood Insurance Act of 1968 (Title XIII of Housing and Urban Development Act of 1968), effective January 28, 1969 (33 FR 17804, November 28, 1968), as amended; 42 U.S.C. 4001–4128; and Secretary's delegation of authority to Federal Insurance Administrator, 34 FR 2680, February 27, 1969, as amended by 39 FR 2787, January 24, 1974.)

Issued: January 9, 1976.

HOWARD B. CLARK,
Acting Federal Insurance Administrator.

[FR Doc.76-2571 Filed 1-29-76;8:45 am]

[Docket No. FI-846]

PART 1917—APPEALS FROM FLOOD ELEVATION DETERMINATION AND JUDICIAL REVIEW

Notice of Proposed Flood Elevation Determination for Township of Cheltenham, Montgomery County, Pa.

The Federal Insurance Administrator, in accordance with Section 110 of the Flood Disaster Protection Act of 1973 (P.L. 93–234), 87 Stat. 980, which added Section 1363 to the National Flood Insurance Act of 1968 (Title XIII of the Housing and Urban Development Act of 1968 P.L. 90–448), 42 U.S.C. 4001–4128, and 24 CFR Part 1917 (§ 1917.4(a)) hereby gives notice of his proposed determinations of flood elevations for the Township of Cheltenham, Montgomery County, Pennsylvania.

Under these Acts, the Administrator, to whom the Secretary has delegated the statutory authority, must develop criteria for flood plain management in identified flood hazard areas. In order to participate in the National Flood Insurance Program, the Township must adopt flood plain management measures that are consistent with the flood elevations determined by the Secretary.

Proposed flood elevations (100-year flood) are listed below for selected locations. Maps and other information showing the detailed outlines of the flood-prone areas and the proposed flood elevations are available for review at Mr.